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UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 15,676.
CIVIL.

ARKANSAS-MISSOURI POWER CORPORATION,
APPELLANT,

vs.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS,
APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT,
WESTERN DIVISION, EASTERN DISTRICT OF ARKANSAS.

QUAPAW PRINTING CO., LITTLE ROCK

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FOR THE EIGHTH CIRCUIT

No. 15,676.
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ARKANSAS-MISSOURI POWER CORPORATION,
APPELLANT,

VS.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX, ETC., ET AL.,
APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT,
WESTERN DIVISION OF THE EASTERN DISTRICT
OF ARKANSAS.

INDEX TO RECORD

	Page
Agreement of Parties as to Printed Record	1
Designation of Original Record on Appeal	2
Amended Complaint, No. L. R. 1846 Civil, District Court, involving Taxes 1939	3
Answer to Amended Complaint, No. L. R. 1846, Civil	8
Statement as to Contents of Amended Complaint and Answer, No. L. R. 1847 Civil, District Court, Taxes year 1941	11
Statement as to Contents of Amended Complaint and Answer, No. L. R. 1889 Civil, District Court, Taxes year 1940	12

Complaint, No. L. R. 2296 Civil, District Court, Taxes year 1942 13

Motion to Dismiss Foregoing Complaint as against Roy Pashcal, former Collector of Internal Revenue 18

Answer to Complaint, No. L. R. 2296 Civil 19

Pre-Trial Order February 5, 1954 21

Memorandum of Findings and Conclusions of District Court 23

Judgment of District Court 38

Plaintiff's Request for Admission of Facts 39

Defendant's Response to Plaintiff's Request for Admission of Facts 44

Statement listing and describing all Exhibits Introduced 46

Plaintiff's Exhibit 4, Modified Plan of Reorganization 51

Stipulation of Counsel admitting certain Exhibits in Evidence 53

Statement as to the Omission from Printed Record of Certain Exhibits Admitted in Evidence by Stipuation 56

Plaintiff's Exhibit 8 to Stipulation, Letter dated March 5, 1941 from Internal Revenue Agent in Charge 57

Statement of and Excerpt from Defendant's Exhibit 2 to Stipulation, Mortgage Indenture 61

Defendant's Exhibit 4 to Stipulation, statement of Dividends and Sale Price of East Missouri Power Company Stock 62A

Defendant's Exhibit 5-A to Stipulation, Findings and Order of the Department of Public Utilities of Arkansas 63

Defendant's Exhibit 5-B-1 to Stipulation, Findings and Order of Missouri Public Service Commission dated January 10, 1936 and Supplemental Order No. 1 dated January 4, 1937 67

Defendant's Exhibit 5-B-2 to Stipulation, Order of Missouri Public Service Commission dated April 30, 1937 71

Statement with respect to Defendant's Exhibits 1-B, 1-C, 1-D, and 1-E, Income tax returns for 1937, 1938, 1939 and 1940 79

TRANSCRIPT OF TESTIMONY 79

Statement as to the witnesses testifying on behalf of the Plaintiff 79

Testimony of Homer Woodall for the Defendants 79

Notice of Appeal 83

Docket Entries, No. 1846 Civil 84

Docket Entries, No. 1847 Civil 85

Docket Entries, No. 1889 Civil 86

Docket Entries, No. 2296 Civil 87

Docket Entries, No. Consolidated 1846 Civil 88

In the United States District Court,
Western Division of the
Eastern District of Arkansas.

Arkansas-Missouri Power Corporation Plaintiff, vs. Roy Paschal, et al., Defendants.	Consolidated No. 1846

Agreement of Parties as to
Printed Record.

It is agreed that the following shall constitute the printed record on appeal to the United States Court of Appeals for the Eighth Circuit from a judgment of the United States District Court for the Western Division of the Eastern District of Arkansas entered July 6, 1956 in a case then pending therein entitled, "Arkansas-Missouri Power Corporation, plaintiff v. Roy Paschal, et al, former Collectors of Internal Revenue for the District of Arkansas, Defendants, Consolidated No. 1846."

It is further agreed that the appellant shall file its brief not later than thirty days after the printed record is filed; that the appellees shall have thirty days after the filing of appellant's brief in which to file their brief; and that the appellant shall have fifteen days for filing reply brief after appellees' brief is filed.

T. S. LOVETT, JR.
P. A. LASLEY,
Attorneys for Appellants.

CHARLES K. RICE,
Assistant Attorney General,
Tax Division.
Attorney for Appellees.

Designation of Record.
(Filed Nov. 1, 1956)

By Consent, the parties hereto designate all of the original files and a complete transcript of the evidence for inclusion in the record on appeal, such record to be held at the Office of the Clerk of the District Court, unless it or parts thereof are requested by the Circuit Court of Appeals or some party to the cause for transmission to the Clerk of the Circuit Court of Appeals.

LASLEY & LOVETT,
P. A. LASLEY,
Attorneys for Plaintiff;

CHARLES K. RICE
Assistant Attorney General,
Tax Division.
For Defendants.

In the United States District Court
For the Eastern District of Arkansas,
Western Division

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal and Horace E. Thompson, former Collectors of Internal Revenue for the District of Arkansas, Defendants.	No. L. R. 1846 Civil

Amended Complaint

(Filed in the U. S. District Court for the Eastern District of Arkansas on April 26, 1951)

Comes the Arkansas-Missouri Power Corporation, and for its amended complaint herein, states:

1. That it is a corporation organized under the laws of the State of Delaware and authorized to do business in the State of Arkansas.

2. That the defendant, Roy Paschal, was the Collector of Internal Revenue for the District of Arkansas at Little Rock from May 16, 1940 to August 19, 1945, and the defendant, Horace E. Thompson, was such Collector from August 20, 1945 to May 3, 1948.

3. That jurisdiction of this Court is authorized by 28 U. S. C. A. 41.

4. On or about February 23, 1935, the United States District Court for the Northern District of Illinois, Eastern Division, approved a petition filed February 21, 1931, of the Arkansas-Missouri Power Company, an Arkansas corporation (predecessor of plaintiff), for reorganization pursuant to Section 77B of Chapter VIII of the Federal Bankruptcy Act. The properties of the Arkansas-Missouri Power Company were located in Southeast Missouri and

Northeast Arkansas, and consisted generally of electric generating plants, transmission lines, and local distribution systems, ice manufacturing plants, and a small water system, cash, and accounts receivable. More specific identification will be shown from the books and appraisals ordered made by the Court.

5. The Arkansas-Missouri Power Corporation was organized for the purpose of reorganization of the Arkansas-Missouri Power Company and took with the approval of the Bankruptcy Court title to said property as of May 1, 1937, under a Modified Plan of Reorganization, filed as Exhibit 1 to the Request for Admission of Facts and by reference made a part hereof as Exhibit 4 hereto.

6. At the time of the reorganization, May 1, 1937, the reorganized Company, the plaintiff, entered upon its books Net Plant and other Assets aggregating $4,493,969.94, as follows: Depreciable property, net after accrued depreciation, $3,880,258.75; Land, $132,172.89; Cash and other Asset accounts, less liabilities, $115,955.06; Stock in East Missouri Power Company, $350,000; Salvage Materials, $15,583.24. The fair market value of the above described property at the time of the reorganized Company, was $4,084,587.60, or $409,382.34 less than the same property was entered upon the books of the Company. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75 , as entered upon the books, to $3,470,876.41.

7. For the above described property the reorganized Company issued and delivered First Mortgage 5% Twenty Year Bonds of the aggregate Par value of $2,834,625; 18,897½ shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875; and 165,805 shares of Common Stock of the par value of $165,805. The reorganized Company as of the date of reorganization recorded Capital Surplus of $548,664.94. The aggre-

gate fair market value of the first mortgage bonds, Preferred Stock and Common Stock, was $4,084,587.60 as of May 1, 1937. The fair market value of the bonds on said last mentioned date was $2,409,444; of the Preferred Stock was $680,313.60; and of the Common Stock was $994,830.

8. The reorganization thus consummated and carried out was a taxable reorganization under the income tax laws of the United States.

9. a.—That $25,000 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired in June, 1937, by the payment in cash of par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

b.—That $40,660 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1938 by the payment in cash in par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

c.—That $62,215 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1939 by the payment in cash in par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

d.—That $2,706,765 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1940 by the payment in cash in the par amount of the bonds redeemed plus accrued interest for thirty days from the call date.

10. That by reason of the facts aforesaid the plaintiff suffered a discount of 15% on $2,834,640 par value of bonds, which discount on the bonds retired in 1939 was $9,332.25, and on those retired in 1940 was $406,012.50. The unamortized portion discount suffered on the bonds

retired in 1939 was as of December 31, 1938, $8,541.38 and on the bonds retired in 1940 was $371,604.29.

11. The unamortized discount as of December 31, 1938, suffered on the sale of bonds, is an operating expense deduction in the years 1939 and 1940. With the allowance of these deductions for unamortized discount in 1939 and 1940, there is an operating loss deduction to be carried forward as a deduction into the year 1941. The decreased income in the years 1940 and 1941 creates an excess profits tax credit carry-over to the years 1941 and 1942 with a resultant reduction in excess profits tax in that year. A statement showing the application of said unamortized discount as of December 31, 1938, is made Exhibit 3 hereto.

12. On March 15, 1940, the Arkansas-Missouri Power Corporation filed its corporation income and excess profits tax return for the calendar year 1939 with the then Collector of Internal Revenue, Homer M. Atkins, and on said date, as part of the taxes shown due on said return, paid to the then Collector $10,640.42. Subsequently, on June 6, 1940, September 11, 1940, and December 11, 1940 plaintiff paid the defendant, Roy Paschal as such Collector, $10,640.42, being the total tax reported and paid on said return of $42,461.66, which said amount was assessed on the Commissioner's March, 1940, list of assessments.

13. The full amount of the normal income tax and surtax chargeable to the plaintiff for the year 1939 was $37,395.42. Thus, the plaintiff made an overpayment for said year of $5,542.72.

14. On March 8, 1943, the plaintiff filed a claim for a refund on account of overpayment of taxes for the year 1939 paid in 1940 in the amount of $5,542.72. A copy of said claim is attached to the original complaint in this cause and marked Exhibit 1 thereto, and is by reference made an exhibit to this amended complaint and marked Exhibit 1 hereto. On December 16, 1946, the claim for refund was re-

jected by the Treasury Department. A copy of said rejection is filed with the original complaint herein as Exhibit 2 thereto, and is by reference made a part of this amended complaint as Exhibit 2 hereto.

15. That the defendants erred in not allowing tax credits in the amount of $5,542.73 based on the deduction of an allowance for amortization of bond discount and expense allowable and applicable to the first mortgage bonds of the plaintiff as more fully explained in Exhibit 1.

16. That the amount for which judgment is sought by this amended complaint is against the defendant Horace E. Thompson, $61.47 together with interest thereon from November 21, 1946, until paid, and against the defendant, Roy Paschal, in the amount of $5,481.26, together with interest thereon from the respective dates of payments hereinbefore set out and paid.

17. All of the matters herein concerned were done by the defendants in their discharge of official duties as such Collectors of Internal Revenue.

Wherefore, as in its original complaint, the plaintiff prays judgment against the defendant, Horace E. Thompson, in the sum of $61.47, together with interst thereon from November 21, 1946, until paid, and against the defendant, Roy Paschal, in the sum of $5,481.26, together with interest thereon from the dates of such payments hereinbefore set out until paid; and for all costs and proper relief.

ARKANSAS-MISSOURI POWER CORP.

By; P. A. Lasley

Attorney for Plaintiff

Attached to the above amended complaint were three exhibits. Exhibit 1 is a copy of a claim for refund and 2 is a copy of official notice that the claim for refund was

denied. The pertinent details of these two exhibits are set forth in Finding 5 of the Memorandum of the District Court (R. 24). Exhibit 3 was a calculation showing how the amount sued for was arrived at.

Answer to Amended Complaint

(Filed in the U. S. District Court for the Eastern District of Arkansas on May 24, 1951)

Comes now the defendants Roy Paschal and Horace E. Thompson, former Collectors of Internal Revenue for the District of Arkansas, by their attorney James T. Gooch, United States Attorney for the Eastern District of Arkansas, and for their answer to the amended complaint of the plaintiff, admit, deny and allege as follows:

1. Admit the allegations of paragraphs 1, 2, 3, 5, 8, 9 and 12.

2. Admit the allegations of paragraph 4, provided that "more specific identification will be shown from the books and appraisals ordered made by the Court," as alleged in said paragraph.

3. Deny the allegations of paragraph 6, save and except it is admitted that at the time of the reorganization, May 1, 1937, the reorganized company, the plaintiff, entered upon its books net plant and other assets aggregating $4,493,969.94 as follows: Depreciable property, net after accrued depreciation, $3,880,258.75; land, $132,172.89; cash and other asset accounts, less liabilities, $115,955.06; stock in East Missouri Power Company, $350,000; salvage materials, $15,583.24. Further answering said paragraph, defendants aver that the Commissioner of Internal Revenue for the purpose of computing depreciation for income tax purposes determined the fair market value of the above described property as of May 1, 1937, at the time of reorganization at $4,084,587.60, or $409,382.34 less than the same

property, was entered on the books of the Company; that all of the $409,382.34 was applicable to depreciable property, reducing the figure of $3,880,258.75, as entered upon the books, to $3,470,876.41.

4. Deny the allegations of paragraph 7 of the amended complaint save and except it is admitted that for the above described property the reorganized company issued and delivered first mortgage 5% bonds of the aggregate par value of $2,834,625 as security for which defendants aver that this plaintiff executed a certain mortgage indenture to Continental Illinois National Bank & Trust Company of Chicago and Carl W. Allendorfer, as trustees, dated January 1, 1937, and now a part of this proceeding as Exhibit ..... hereto, which said mortgage included all of the above described property as security for the said $2,834,625 bond issue. Defendants further admit that there was issued 18,897½ shares of 6% cumulative preferred stock of the par value of $50 per share, aggregating $944,875 and 165,805 shares of common stock of the par value of $165,805; admit that the reorganized company as of the date of reorganization recorded capital surplus of $548,644.94.

5. Deny the allegations of paragraphs 10, 11, 13 and 15.

6. Deny the allegations of paragraph 14 save and except it is admitted that plaintiff filed a claim for refund for tax paid for the year 1939 and that the claim for refund was rejected by the Commissioner of Internal Revenue on or about December 16, 1946.

7. For answer to paragraph 16, defendants admit that the amounts for which the suit is brought are $61.47 and $5,481.26.

8. Deny the allegations of paragraph 17, save and except it is admitted that the defendants acted in the discharge of their official duties in making collections herein complained of.

Wherefore, defendants pray as in their original answer, and that the amended complaint of the plaintiff be dismissed, for their costs and all other proper relief.

GERLAND P. PATTEN
Assistant U. S. Atty.

JAMES T. GOOCH
United States Attorney

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal and Horace E. Thompson, former Collectors of Internal Revenue for the District of Arkansas, Defendants.	No. L. R. 1847 Civil

Amended Complaint

(Filed in the U. S. District Court of the Eastern District of Arkansas on April 26, 1951)

By this complaint the plaintiff sought to recover on account of alleged overpayment of taxes for the year 1941 of Roy Paschal the sum of $89,504.33 and of Horace E. Thompson the sum of $1,839.93. The amended complaint in this cause is substantially identical with that filed in number 1846 set forth on R. 3, with the exception of the allegations with respect to the year involved, the filing of the return for that year, the amount of the tax paid, the claim for refund, and the denial of the claim. The details of all of the exceptions, as well as those of Exhibits 1 and 2, attached to said complaint are found in Finding 9 of the Memorandum of the District Court (R. 25). Exhibit 3 attached to the amended complaint was a calculation showing how the amount sued for was determined.

The answer to the above amended complaint was substantially the same as that filed in 1846 (R. 8). The only changes were those necessary because of the different year and amounts involved.

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal, former Collector of Internal Revenue for the District of Arkansas Defendant.	No. 1889 Civil

Amended Complaint

(Filed in the U. S. District Court for the Eastern District of Arkansas on April 26, 1951)

By this complaint the plaintiff sought to recover on account of alleged overpayment of taxes for the year 1940 of Roy Paschal the sum of $51,607.36. This amended complaint is substantially identical with that filed in 1846 Civil set forth on R. 3, with the exception of the allegations with respect to the year involved, the filing of the return for that year, the amount of the tax paid, the claim for refund, and the denial of the claim. The details of all of the exceptions, as well as those of Exhibits 1 and 2 attached to said complaint, are found in Finding 7 of the Memorandum of the District Court (R. 24). Exhibit 3 attached to this complaint was a calculation showing how the amount sued for was determined.

The answer to the above amended complaint was substantially the same as that filed in 1846 (R. 8). The only changes were those necessary because of the different year and amounts involved.

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal, former Collector of Internal Revenue for the District of Arkansas, and W. D. Self, Acting Collector, Defendants.	No. L. R. 2296 Civil

Complaint

(Filed in the U. S. District Court for the Eastern District of Arkansas on June 21, 1951)

Comes the Arkansas-Missouri Power Corporation, and for its complaint herein, states:

1. That it is a corporation organized under the laws of the State of Delaware and authorized to do business in the State of Arkansas.

2. That the defendant, Roy Paschal, was the Collector of Internal Revenue for the District of Arkansas at Little Rock from May 16, 1940 to August 19, 1945, and the defendant, W. D. Self, has been Acting Collector for said District since May 4, 1948.

3. That jurisdiction of this Court is authorized by 28 U. S. C. A. 41.

4. On or about February 23, 1935, the United States District Court for the Northern District of Illinois, Eastern Division, approved a petition filed February 21, 1931, of the Arkansas-Missouri Power Company, an Arkansas corporation, (predecessor of plaintiff), for reorganization pursuant to Section 77B of Chapter VIII of the Federal Bankruptcy Act. The properties of the Arkansas-Missouri Power Company were located in Southeast Missouri and Northeast Arkansas, and consisted generally of electric generating plants, transmission lines, and local distribu-

tion systems, ice manufacturing plants, and a small water system, cash, and accounts receivable. More specific identification will be shown from the books and appraisals ordered made by the Court.

5. The Arkansas-Missouri Power Corporation was organized for the purpose of reorganization of the Arkansas-Missouri Power Company and took with the approval of the Bankruptcy Court title to said property as of May 1, 1937, under a Modified Plan of Reorganization, filed as Exhibit 1 hereto.

6. At the time of the reorganization, May 1, 1937, the reorganized Company, the plaintiff, entered upon its books Net Plant and other Assets aggregating $4,493,969.94, as follows: Depreciable property, net after accrued depreciation $3,880,258.75; Land, $132,172.89; Cash and other Asset accounts, less liabilities, $115,955.06; Stock in East Missouri Power Company, $350,000; Salvage Materials, $15,583.24. The fair market value of the above described property at the time of the reorganized Company, was $4,084,587.60, or $409,382.34 less than the same property was entered upon the books of the Company. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75, as entered upon the books, to $3,470,876.41.

7. For the above described property the reorganized Company issued and delivered First Mortgage 5% Twenty Year Bonds of the aggregate Par value of $2,834,625; 18,897½ shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875; and 165,805 shares of Common Stock of the par value of $165,805. The reorganized Company as of the date of reorganization recorded Capital Surplus of $548,664.94. The aggregate fair market value of the first mortgage bonds, Preferred Stock and Common Stock, was $4,084,587.60 as of May 1, 1937. The fair market value of the bonds on said

last mentioned date was $2,409,444; of the Preferred Stock was $680,313.60; and of the Common Stock was $994,830.

8. The reorganization thus consummated and carried out was a taxable reorganization under the income tax laws of the United States.

9. A. That $25,000 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired in June, 1937, by the payment in cash of par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

B. That $40,660 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired in June, 1938, by the payment in cash of par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

C. That $62,315 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1939 by the payment in cash in par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

D. That $2,706,765 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1940 by the payment in cash in the par amount of the bonds redeemed plus accrued interest for thirty days from the call date.

10. That by reason of the facts aforesaid the plaintiff suffered a discount of 15% on $2,834,640 par value of bonds, which discount on the bonds retired in 1939 was $9,332.25, and on those retired in 1940 was $406,012.50. The unamortized portion discount suffered on the bonds retired in 1939 was as of December 31, 1938, $8,541.38 and on the bonds retired in 1940 was $371,604.29.

11. The unamortized discount as of December 31, 1938, suffered on the sale of bonds, is an operating expense de-

duction in the years 1939 and 1940. With the allowance of these deductions for unamortized discount in 1939 and 1940, there is an operating loss deduction to be carried forward as a deduction into the year 1941. The decreased income in the years 1940 and 1941 creates an excess profits tax credit carry-over to the years 1941 and 1942 with a resultant reduction in excess profits tax in that year. A statement showing the application of said unamortized discount as of December 31, 1938, is made Exhibit 2 hereto.

12. Prior to, or on, March 11, 1943, the plaintiff filed its corporation income and excess profits tax return for the calendar year 1942 with the then Collector of Internal Revenue, the defendant, Roy Paschal, and on the dates next set forth, paid the amounts set opposite dates to said Roy Paschal on account of Normal and surtax and excess profits taxes, as follows:

Date Paid	Total Taxes Paid	Excess Profits Tax	Normal and Surtax
March 11, 1943	$37,834.84	$13,132.85	$24,701.99
April 13, 1943	8,064.40	2,799.26	5,265.14
June 10, 1943	45,899.24	15,932.10	29,967.14
September 11, 1943	45,899.24	15,932.11	29,967.13
December 6, 1943	45,899.24	15,932.10	29,967.14

On August 31, 1949, the plaintiff paid to the then Acting Collector, the defendant, W. D. Self, on account of excess profits taxes the sum of $56,498.12 and paid on June 7, 1950 to the defendant, W. D. Self, the then acting Collector the sum of $40,163.87, of which $24,376.86 was on account of excess profits taxes for the year 1942 and $15,787.01 on account of interest demanded by said W. D. Self as said Collector. On June 30, 1950, the plaintiff made a further payment to the defendant, W. D. Self, the then Acting Collector in the sum of $16,687.57, balance of interest claimed to be due upon the taxes for the year 1942, making a total tax payment for said years of $224,308.07, and a total interest payment of $32,474.58.

13. The full amount of the normal income and surtax due by the plaintiff for the year 1942 was $100,814.74 and

the total amount of excess profits taxes due for said year were $100,919.97, making a total tax due of $201,734.72. Thus, the plaintiff made an overpayment on account of said taxes for said year of $22,573.36, and on account of interest of $9,794.51.

14. That on June 12, 1950, the plaintiff filed a claim for refund on account of overpayment of taxes for the year 1942 paid in 1943 for more than the amount of $22,573.36, plus interest in the amount of $9,794.51, the amount sued for herein. Although said claim for refund has been filed and pending before the Commissioner of Internal Revenue for more than six months, he has failed, neglected, or refused to approve or reject the same, and the plaintiff is entitled under Section 3772 (a) (2) of the Internal Revenue Code to bring suit on account of the overpayment for said year.

15. That the defendants erred in not allowing tax credits in the amount of $22,573.36 based on the deduction of an allowance for amortization of bond discount and expenses allowable and applicable to the first mortgage bonds of the plaintiff as more fully explained in Exhibit 2 attached hereto.

16. That the amounts for which judgment is sought in this complaint is against the defendant, W. D. Self, Acting Collector, $32,367.87, of which $22,573.36 is on account of overpayment of excess profits taxes for the year 1942 and $9,794.51 is on account of overpayment of interest claimed to be due on taxes for said year, together with interest thereon until paid.

17. All of the matters herein concerned were done by the defendants in their discharge of official duties as such Collectors of Internal Revenue.

Wherefore, the plaintiff prays judgment against the defendant, W. D. Self, acting Collector aforesaid, in the sum of

$32,367.87, together with interest with respect to the $22,-573.36 from June 7, 1950, and with respect to $9,974.51 from January 30, 1950, and for all costs and proper relief.

ARKANSAS-MISSOURI POWER CORPORATION

By: P. A. Lasley

Attorney for Plaintiff

Attached to the complaint as Exhibit 1 was the Modified Plan of Reorganization. It was admitted in evidence as Plaintiff's Exhibit 4. The District Court made the Modified Plan of Reorganization together with its exhibits a part of its Finding 22 and the Plan is set forth at R. 51. Exhibit 2 was a calculation showing how the amount sued for was arrived at.

Separate Motion of Roy Paschal Former Collector of Internal Revenue for the District of Arkansas

(Filed in the U. S. District Court for the Eastern District of Arkansas on August 20, 1951)

Roy Paschal, former Collector of Internal Revenue for the District of Arkansas, one of the defendants in this proceeding, by his attorney, James T. Gooch, United States Attorney for the Eastern District of Arkansas, moves the Court to dismiss as to him, because the complaint shows upon its face that he is not a proper party defendant, in the following particulars:

(1) That the amounts sought to be recovered in this action were paid to W. D. Self, Acting Collector, long after the tenure in office of this movant; (2) That the plaintiff does not ask judgment against him in this action.

Accordingly, said defendant prays that his motion be granted and that the action against him be dismissed.

Answer

The defendants by their attorney, James T. Gooch, United States Attorney for the Eastern District of Arkansas, still insisting that the separate motion of Roy Paschal should be granted, answer the complaint of the plaintiff as follows:

1. Admit.

2. Admit, except it is averred that W. D. Self was Acting Collector for said district only until July 1, 1951.

3. Admit.

4. Admit provided that "more specific identification will be shown from the books and appraisals ordered made by the Court" as alleged.

5. Admit.

6. Deny, except it is admitted that at the time of the reorganization May 1, 1937, the reorganized company, the plaintiff, entered upon its books net plant and other assets aggregating $4,493,969.94, as follows: Depreciable property, net after accrued depreciation, $3,880,258.75; land, $132,172.89; cash and other asset accounts, less liabilities, $115,955.06; stock in East Missouri Power Company, $350,000; salvage materials, $15,583.24.

Further answering said paragraph, defendants aver that the Commissioner of Internal Revenue, for the purpose of computing depreciation for income tax purposes, determined the fair market value of the above described property as of May 1, 1937, at the time of reorganization, at $4,086,587.60, or $409,382.34 less than the same property was entered on the books of the company; that all of the $409,382.34 was applicable to depreciable property, reducing the figure of $3,880,258.75, as entered upon the books, to $3,470,876.41.

7. Denies, except it is admitted that for the above described property the reorganized company issued and de-

livered first mortgage 5% bonds of the aggregate par value of $2,834,625 as security for which defendants aver that this plaintiff executed a certain mortgage indenture to Continental Illinois National Bank and Trust Company of Chicago, and Carl W. Allendorfer, as trustee, dated January 1, 1937, which said mortgage included all of the above described property as security for the said $2,834,625 bond issue. Defendants further admit that there was issued 18,897½ shares of 6% cumulative preferred stock of the par value of $50 per share, aggregating $944,875, and 165,805 shares of common stock of the par value of $165,805, and admit that the reorganized company at the date of reorganization recorded capital surplus of $548,664.94.

8. Admit.

9. Admit.

10. Deny.

11. Deny.

12. Deny, except it is admitted that on or about March 11, 1943, plaintiff filed its corporation income and excess profits tax return for the calendar year 1942 with the then Collector of Internal Revenue Roy Paschal, and made certain payments of tax reported due on said return. It is further admitted that on August 13, 1949, and not on June 7, 1950, as alleged, and on July 7, 1950, the plaintiff made certain payments to the defendant W. D. Self, then Acting Collector of Internal Revenue. The exact amounts paid will be shown from the Collector's certificate at the trial of this cause

13. Deny.

14. Deny, except it is admitted that on June 14, 1950, plaintiff filed with Acting Collector Self a claim for refund.

15. Deny.

16. Deny.

17. Admit.

Wherefore, having fully answered defendants pray for a judgment in their favor, for costs and all other proper relief.

/s/ JAMES T. GOOCH
United States Attorney
Attorney for Defendant
By R. D. Smith, Jr.
Assistant United States Attorney

In the United States District Court
Eastern District of Arkansas
Western Division

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal and Horace E. Thompson, former Collectors of Internal Revenue for the District of Arkansas, Defendants.	Civil No. 1846

Pre-Trial Order

(Filed in the U. S. District Court for the Eastern District of Arkansas on February 5, 1954)

On this the 4th day of February, 1954, the above cause came on for hearing on Pre-trial, the plaintiffs being represented by P. A. Lasley, the defendants being represented by Lester L. Gibson, Attorney for the Department of Justice, and the following matters were agreed upon. It was agreed that there are only three factual issues in the case for further consideration.

1. The market value of the securities involved on the date of the exchange, May 1, 1937, it being the position of counsel for the defendants that this matter of the market value of securities is immaterial and not necessary for a decision in the case, and it being the contention of the plaintiff that by exhibits, testimony, other documents and statement of counsel the market value of the securities at the date indicated has been established.

2. The value of the property received by the plaintiff at the time of the exchange, May 1, 1937.

3. The amount of taxes and/or interest paid as a basis for plaintiff's recovery.

Subject to the right of any party to object for irrelevancy or immateriality, any excerpts from the appraisal of Day and Zimmerman dated May 31, 1955, may be read as evidence before the court.

It is agreed that, subject to the right of any party to object for irrelevancy or immateriality, all or any portion of the pleadings and documents filed or introduced before, or Orders made by the Department of Public Utilities of the State of Arkansas in connection with the re-organization plan of the Arkansas-Missouri Power Company, as well as such pleadings, documents and Orders of the Missouri Public Service Commission, may be introduced in evidence before the Court.

A Jury is waived by both parties.

It is agreed that all issues of fact will be submitted to the court on depositions, stipulations or admissions.

It is so ordered.

THOMAS C. TRIMBLE
Chief Judge
United States District Court

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal, et al., former Collectors of Internal Revenue for the District of Arkansas, Defendants.	Consolidated No. 1846

Memorandum

(Filed in the U. S. District Court for the Eastern District of Arkansas on July 6, 1956)

1. This proceeding, consolidated for trial under Civil No. 1846, seeks the recovery, in separate suits, of income taxes, plus statutory interest, as follows:

1939	$ 5,542.73
1940	51,607.36
1941	91,244.26
1942	32,367.87
Total	$180,762.22

2. The Arkansas-Missouri Power Corporation, plaintiff in all of the consolidated cases, is a corporation organized under the laws of the State of Delaware as successor corporation to Arkansas-Missouri Power Company and is authorized to do business in the State of Arkansas. The various defendants were each severally Collectors of Internal Revenue for the District of Arkansas during the periods involved.

3. On March 15, 1940, the Arkansas-Missouri Power Corporation filed its corporation income and excess profits tax return for the calendar year 1939 with the then Collector of Internal Revenue, Homer M. Adkins, and on said date, as part of the taxes shown due on said return, paid

to the then Collector $10,640.42. Subsequently, on June 6, 1940, September 11, 1940, and December 11, 1940, it paid the defendant Roy Paschal, as such Collector, $10,640.42, being the total tax reported and paid on said return of $42,461.66.

4. On April 10, 1941, after an audit of said return, plaintiff paid to the defendant Roy Paschal a deficiency assessment of $315, which was assessed on the Commissioner's April, 1941, assessment list, and in November, 1946, the Commissioner assessed a further deficiency of $61.41 which was paid to Collector Horace E. Thompson. These additional assessments are not material to the issue involved herein.

5. On March 10, 1943, plaintiff filed with Roy Paschal, as Collector aforesaid, a claim for refund of $5,542.73 of the amounts so paid, together with interest. The claim for refund was rejected December 16, 1946. The basis of the claim for recovery is in words and figures as follows:

> The tax to be refunded (along with interest thereon) was paid on $29,172.22 denied as an allowance of amortization of bond discount and expense applicable to the First Mortgage 5 per cent Series A bonds due January 1, 1957 issued by the Taxpayer.

6. On March 8, 1941, plaintiff filed a tentative corporation income and excess profits tax return for the year 1940 with the defendant Roy Paschal, as Collector. Its final return was filed on or about May 6, 1941, and on March 7, May 1, June 5, and September 9, 1941, plaintiff paid to the defendant Roy Paschal, as Collector, taxes for the year 1940 amounting to $51,859.19, as shown due on said return.

7. On July 18, 1942, plaintiff filed a claim for refund with defendant Roy Paschal, as Collector, for refund of $51,859.19, with interest, and on or about March 27, 1947, said claim for refund was rejected, except as to an item of

$251.83 allowed as an overassessment, which is not material to a decision here. The basis of the claim for recovery is in words and figures as follows:

> In report of March 5, 1941, IT:GCS:WMCM, signed by the Internal Revenue Agent in Charge, Oklahoma City, Okla., a valuation of 85% was placed upon our 1st Mortgage Bonds as at May 1, 1937; such bonds were retired by cash paid in 1940, consequently, bond discount was realized in 1940 which cancels the taxable income shown on our 1940 income tax return—Form 1120.

8. On March 14, 1942, plaintiff filed its corporation income and declared value excess profits tax return for the year 1941 with the defendant Roy Paschal, as Collector. On that date and on June 8, September 3, and December 14, 1942, plaintiff paid to the defendant Roy Paschal, as Collector, the full amount of tax reported due in the sum of $180,235.95, which said amount was assessed on the Commissioner's 1942 March list. After an audit, and on November 21, 1946, plaintiff paid to defendant Horace E. Thompson, as Collector, a deficiency assessment on account of additional income tax earned for the year 1941 the sum of $1,839.93.

9. On May 10, 1943, plaintiff filed with defendant Horace E. Thompson, as Collector, a claim for refund of $91,344.26 of the amount paid, with interest, which claim was rejected December 16, 1946. The basis of the claim for recovery is in words and figures as follows:

> The tax to be refunded (along with interest thereon) was paid on $111,695.45 denied as an operating loss carry-over arising from the retirement in 1940 of First Mortgage 5% Bonds, Series A, due January 1, 1957, in principal amount of $2,706,750, issued by the Taxpayer in 1937 and valued at 85%, thereby establishing a discount of 15%. The remaining discount realized in

1940 on the $2,706,750 principal amount of bonds outstanding as at December 31, 1939 was 12.9666% or $350,973.45 which resulted in a deficit of $113,305.54 for the taxable year ended December 31, 1940.

10. On or about March 11, 1943, plaintiff filed its corporation income and excess profits tax return for the calendar year 1942 with the defendant Roy Paschal, as Collector, and paid the amounts reported due on said return.

11. On June 12, 1950, plaintiff filed a claim for refund for the year 1942 in the amount of $22,573.36, plus interest thereon in the amount of $9,794.51. The said claim for refund for 1942 likewise was based upon a credit carry-over on account of alleged amortization of bond discount in prior years. The Commissioner has not rejected this claim.

12. The history of the taxpayer corporation may be summarized as follows: On or about February 23, 1935, the United States District Court for the Northern District of Illinois, Eastern Division, approved a petition filed February 21, 1931, of the Arkansas-Missouri Power Company, an Arkansas corporation (predecessor of plaintiff), for reorganization pursuant to Section 77B, Chapter VIII, of the Federal Bankruptcy Act. The properties of the Arkansas-Missouri Power Company were located in 17 counties of Southeast Missouri and Northeast Arkansas and consisted generally of electric generating plants, transmission lines, local distribution systems, ice manufacturing plants, a water system, and cash, accounts receivable.

13. In accord with such plan, and as set forth in such plan, taxpayer acquired all the properties of the old company, subject to its mortgage to the St. Louis Union Trust Company, as trustee, dated January 1, 1923, securing its first mortgage bonds and its taxes and assessments which were a lien on this property with the understanding that a certain unfinished transmission line would be retained by

the old company pending complete construction thereof. This property was later turned over to the taxpayer, the new corporation.

14. While the affairs of the old company were in the hands of the District Court and pursuant to the authority and by direction of said United States District Court for the Northern District of Illinois and by consent of the interested parties, Day & Zimmerman, Inc., a nationally known and reputable firm of appraisal engineers, was employed and directed to inventory the property of the predecessor, Arkansas-Missouri Power Company, and make an appraisal report in respect to all the properties of said company.

15. Thereafter, Day & Zimmerman, Inc., carried out the appraisal and set forth the results thereof in a report, dated August 26, 1935, entitled "Report No. 3092, on Arkansas-Missouri Power Company, Blytheville, Arkansas," which is filed herein as Plaintiff's Exhibit 9. This report was the basis of the plan of reorganization of the Arkansas-Missouri Power Company and was entitled "Modified Plan of Reorganization of the Arkansas-Missouri Power Company."

16. Pursuant to the Modified Plan of Reorganization the Arkansas-Missouri Power Corporation was organized for the purpose of reorganization of the Arkansas-Missouri Power Company and took title to said property as of May 1, 1937, under the Modified Plan of Reorganization and with the approval of the Bankruptcy Court.

17. Pursuant to the Modified Plan of Reorganization the Arkansas-Missouri Power Corporation, taxpayer herein, caused to be issued as of May 1, 1937, $2,834,640 of First Mortgage 5% bonds due January 1, 1957; $944,880 of 6% Cumulative Preferred Stock of a par value of $50 per share; and 165,805 shares of Common Stock of a par value of $1 per share in exchange for the properties of the Arkansas-Missouri Power Company and the surrender of the

bonds held by the prior mortgagor, whereupon these securities were distributed as shown in the Modified Plan of Reorganization.

18. As a result of the appraisal by the engineers the property values of the old company were reduced when brought to the books of the taxpayer and, in turn, the taxpayer's net values were reduced by the Internal Revenue Service. These reductions are summarized as follows:

	Company	Taxpayer Per Books	Amended IT:OCS:
Utility Plants:			
Depreciable	$4,562,329.04	$4,559,170.84	$4,559,170.84
Non-depreciable	2,032,701.39	132,172.89	132,172.89
Totals	6,595,030.43	4,691,343.73	4,691,343.73
Less: Depreciation	177,816.17	678,912.09	1,088,294.43
Net values	6,417,214.26	4,012,431.64	3,603,049.30
Taxpayers's 1st Mtg. Bonds		2,834,625.00	2,834.625.00
Excess of properties over bonds		1,177,806.64	768,424.30

19. The original plan of reorganization did not meet with the approval of the Public Utilities Commission of the State of Missouri and an order, dated January 10, 1936, was entered approving said plan upon condition that the accruals for retirement expenses should be based upon the engineers' estimate of the depreciable property of the Arkansas-Missouri Power Company as of May 31, 1935, and subsequent net additions and betterments to such property. On April 30, 1937, an order was entered approving said Modified Plan of Reorganization by the Missouri Public Service Commission.

20. A similar order was entered on Janury 8, 1937, by the Department of Public Utilities of the State of Arkansas, wherein it ordered that the amount of the securities to be issued under the Modified Plan of Reorganization should not exceed the fair value of the property involved.

21. In the approval of the Public Service Commission of the State of Missouri, dated April 30, 1937, after detailing the manner in which the reorganization should be carried out, both as to the mortgage indenture and the bonds is-

sued thereunder, as well as the exchange for stock, the Commission found and was of the opinion —

> • • • that the amount of stocks, bonds, warrants special bond coupons and cash scrip proposed to be issued under the said Modified Plan of Reorganization does not exceed the fair value of the property involved and further finds that, in its opinion, the property to be paid for by the issuance of said securities is reasonably required for the purpose of affecting a reorganization of Arkansas-Missouri Power Company.

22. The reorganization was carried out pursuant to the terms and conditions of the Modified Plan of Reorganization agreed to by the interested parties, the Federal District Court before whom the proceeding was pending, and approved by the Public Utilities Commissions of the States in which the company operated. The Modified Plan of Reorganization, together with exhibits thereto, is by reference made a part of this finding. (The Modified Plan referred to is found at R. 51).

23. The reorganization thus consummated and carried out was a taxable reorganization under the income tax laws of the United States.

24. It may be further stated that at the time of reorganization on May 1, 1937, the plaintiff entered upon its books net plant and other assets aggregating $4,493,969.94 as follows: Depreciable property, net after accrued depreciation — $3,880,258.75; Land and non-depreciable property — $132,172.89; Cash and other asset accounts, less liabilities assumed — $115,955.06; Common Stock of East Missouri Power Company, net — $350,000; Salvage Materials — $15,583.24.

25. The fair market value of the property listed in the above paragraph as of May 1, 1937, the date of reorganization, did not exceed $4,084,587.60 or $409,382.34 less than

the same property was entered on the books of the plaintiff. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75 to $3,470,876.61.

26. For the property described above the plaintiff, as heretofore stated, issued and delivered as of May 1, 1937, for distribution as per said Modified Plan of Reorganization, bonds of the aggregate par value of $2,834,625; 18,897½ shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875; 165,805 shares of Common Stock of the par value of $165,805; and paid the cash and delivered the scrip, all as provided by said Modified Plan.

27. The plaintiff also entered upon its books as of the date of the reorganization capital surplus of $548,664.94. It is established that the fair market value on May 1, 1937 of the securities issued as aforesaid was as follows: $2,834,625 par value First Mortgage 5% Bonds, at 85% of par, aggregating $2,409,444 or $425,181 less than par; 18,897½ shares of 6% Cumulative Preferred Stock, $36 per share, aggregating $680,313.60; 165,805 shares of Common Stock, $6 per share, aggregating $994,830, making a total aggregate fair market value of the securities of $4,084,587.60.

28. The following is a statement showing assets received at May 1, 1937, in exchange for securities in reorganization:

	Per Books	Adj.	As Amended
Depreciable Property	$3,880,258.75	—409,382.34	$3,470,876.41
Non depreciable Property	132,172.89		132,172.89
Property Salvage	15,583.24		15,583.24
Stock East Mo. Power Co.	350,000.00		350,000.00
Cash	612,590.96		612,590.96
Other Assets	302,770.79		302,770.79
	$5,293,376.63		$4,883,994.29
Liabilities Assumed	799,406.69		799,406.69
Net Worth	4,493,969.94		4,084,587.60
Securities Issued			
First Mortgage Bonds	2,834,625.00		2,834,625.00
Preferred Stock at Par	944,875.00		944,875.00
Common Stock at Par	714,460.94		
		—409,382.34	305,087.60
	$4,493,969.94		$4,084,587.60

29. The foregoing assets were included in their entirety in the mortgage indenture given by the taxpayer to the trustees to secure the first mortgage bond issue.

30. Subsequent to the redemption of the bonds in 1940 the entire capital stock of East Missouri Power Company, which cost its predecessor, Arkansas-Missouri Power Company, $563,675, was sold on June 7, 1945, at a price of $600,000, the value of which had been shown on the statement of assets received as of May 1, 1937, in exchange for securities in reorganization at $350,000.

31. At the date of the redemption of the bonds in 1940 there had been no other sales of the properties given to secure the mortgage indenture of January 1, 1937, but the balance sheets of the taxpayer issued subsequent to May 1, 1937, indicated additions by way of purchase and increase in value of all the assets to and including the redemption of the bonds.

The foregoing statement comprises various findings of fact proposed by counsel for both parties and will be considered the Court's Findings of Fact, the controlling elements of which are these: First, the total fair market value of the assets received by the plaintiff on May 1, 1937, established by competent evidence was $4,084,587.60 and the total fair market of the bonds and stock given in exchange for the assets likewise established was, on May 1, 1937, $4,084,587.60, the fair market value of the preferred stock at $36 a share being $630,313.60, the fair market value of the common stock at $6 a share being $994,830, and the fair market value of the bond issue at 85c on the dollar being $2,409,440.

From this it is seen that the aggregate fair market value of the common and preferred stock and the par value of the bonds exceeds the fair market value of the assets to the extent of more than $400,000. However, by no method

of calculation can the value of the assets be found to be less than the par value of the bonds.

The difficulty that confronts the court is the attempt to find the answer to the questions of law posed by counsel for both parties. The first of these questions, the one argued at length, both orally and in the briefs, is whether the Treasury Regulations providing for deductions as interest of "discounts" on bonds apply in cases where, in a reorganization proceeding, bonds are exchanged for property. The other question is whether the bonds in this case were issued, or exchanged, at a discount.

With respect to the answer to the first question, the decisions of the Board of Tax Appeals and the Courts of Appeal have had the effect of confusing me as to what is the correct answer or whether the answer has in fact been found.

Counsel for plaintiff places considerable reliance upon the case of *American Smelting and Refining Company* v. *United States,* 130 F. 2d 883. This opinion does squarely hold that the discount in the exchange of bonds for stock to the extent of the excess of the par value of the bonds over the market value of the stock is to be treated as interest. In that case bonds were issued in exchange for the stock of a subsidiary company and the taxpayer claimed that it suffered a loss when it was required to give a share holder a plus cash payment of $7.50 in the exchange of a $100 5% bond for a $100 par value share of preferred stock. The court in passing on this question said:

> "We believe that the discount is still to be treated as additional interest when the subject matter of the loan is stock instead of cash. It is clear in both cases that the discount, or additional interest, is determined at the time the bonds are issued. Thus, when the investor is paid the face amount of the bond at maturity, he is taxable for the difference between that sum and

the cost of the bond. Here the cost of the bond is the fair market value of the stock at the time the corporate obligations were exchanged. To sustain the government's contention, in view of these considerations, would be to say, in effect, that, on the same loan, the taxable 'interest' earned by the investor varies in amount and is computed as of a different time than the deductible 'interest' paid by the obligor. We think that this not only distorts, unnecessarily, the ordinary incidents of a commercial transaction but also upsets the balance of the tax situation.

We do not think, therefore, that the question whether amortization is permitted is settled by making the dividing line between transactions in which bonds are issued for cash and transactions where bonds are issued for something else. We do see the possibilities of great difficulty in determining, with sufficient exactness, the difference between the par value of the bonds and the thing other than cash received for the bonds by the obligor. We think in this case the taxpayer has met that difficulty, except as to part of the 5% shares, discussed below. He has shown the selling price of part of the 5% and all the 6% preferred stock of the company whose shares the taxpayer took in for the bonds, and this by reference to the open market of the New York Stock Exchange. This is further checked by showing the selling price of the taxpayer's bonds in transactions shortly after, or during the time under consideration. It is proof, it seems to us, sufficient to establish the value of what was received in exchange for the bonds issued. It shows the stock, when received, was worth less than the par value of the bonds given for it and how much less. That seems to us to bring the taxpayer within the rule which permits the amortization of this discount under the rules stated by the Regulations and approved by the Supreme Court."

There was a logical dissenting opinion by Circuit Judge Jones in the American Smelting and Refining Company case and the subject again arose before the same court (United States Circuit Court of Appeals, Third Circuit) in the case of the *Montana Power Company, Appellant* v. *United States*, 232 F. 2d 541.

Seven judges sat as the Court of Appeals in that case, including Judges Goodrich and Biggs who rendered the majority opinion in the American Smelting and Refining Company case. All of the members of the court except Chief Judge Biggs voted to affirm the judgment of the District Court on the ground that the taxpayer was not entitled to relief on account of failure to establish the fair market value of the property involved. The opinion of the court was written by Judge Kalodner in portions of which he and Judge Staley only concurred, with Judge Hastie joining them in their conclusion in one very important portion of the opinion. Chief Judge Biggs dissented in part and concurred in part. The result of the decision of the Court in the Montana Power Company case is that six of the judges are in agreement on the necessity of the establishment of the fair market value of the property involved; two of them express the view that the Treasury Regulations relating to bond discounts are inapplicable in situations where bonds are issued in payment of property; three of them are in agreement that where bonds are issued in payment of property, the Treasury Regulations regarding discount cannot be invoked where there was no arms-length dealing. The reasoning and the authority cited in the concurring portion of the opinion are strongly persuasive, both on the position taken by the concurring judges that the discount of bonds is applicable only where there is a *sale* of the bonds as differentiated from the *issuance* thereof, and on the position taken by the concurring judges that the bond discount provision of the Treasury Regulations can never be made available in reorganizations under the Bankrupt-

cy Act where there was no arms-length dealing. However, due to the division of authority at the present time, I am still left in doubt as to what the result will be when these two questions are fully considered and definitely answered by the appellate courts.

I am somewhat in the position of the majority of the presiding judges in the Montana Power Company case, because I have reached a determination of the main issue in this case for a reason other than those discussed by Judge Kalodner.

The plaintiff must stand or fall upon its position that its bond issue of $2,834,640 was exchanged at a discount because the aggregate par value of the bonds and the fair market value of the stock issued and delivered for the assets received exceeded the fair market value of the assets to such an extent as to amount to a 15% discount of the bonds. If the stock issued had represented obligations of the corporation as did the bonds, a basis to support this position of the plaintiff would be found. But that was not the situation at all. Stocks such as these constitute what in trade-parlance are known as "equities." They may be of great value, of small value, or of no value at all. They had no maturities, and were not direct charges against the assets of the company. True, it was shown, in fact, it was admitted that the stock had a market value but that did not affect the liability of the plaintiff company. The liability of the company for the payment of money was limited to the par value of the bonds issued and it received property having a value in excess of the amount of the bonds issued.

It would unduly extend this memorandum to cite the voluminous authorities that support the principle that the entire assets of the corporation were subject to the payment of the bonds as opposed to any claims of the stockholders and that due to this well established principle of law, the plaintiff cannot maintain its position that the as-

sets received by it in the reorganization were less in value than the face value of the bonds issued.

I have not overlooked the citations contained in plaintiff's brief of the Pierce Oil Corporation case, the Hummel-Ross Fiber Corporation case, and The Natural Gas Pipeline Company of America case.

I believe that in none of those cases does it appear that the property received in exchange for the bonds was of greater value than the par value of the bonds. In the Natural Gas Pipeline Company case, 45 BTA 939, the Commissioner was merely recognizing a contractual agreement between the company and the holders of its outstanding two year 8% notes. The effect of the opinion was to permit the amortization of a discount which arose as a result of the delivery of the taxpayers $60,000,000 6% bonds along with 1,499,000 shares of common stock in payment for the surrender of notes of the taxpayer in the amount of less than $60,000,000 principal and accrued interest. It is apparent that in that case the bonds were issued at a discount and the litigation arose not over the question of the right to pro rate the bond discount, but upon the amount to which it was entitled.

Plaintiff's complaint is that it actually received property that was of less value than the par value of the bonds and the market value of the stocks issued. In other words, that it paid too much for the property and that theoretically it was euchred out of $409,000 by what it terms the arbitrary maneuver of a tax official in reducing its basis for depreciation. By this action, plaintiff charges, an injustice has resulted. Plaintiff itself has, in the trial of this case, arrived at practically the same valuation of its assets as that fixed for tax purposes. No effort was made by the plaintiff so far as this record shows to effect a re-evaluation of the assets, but it is now attempting to restore its alleged tax losses by the means of this suit. Or, perhaps I should

say it is plaintiff's position that the Government by this action of reducing the value of its property has laid itself liable to the plaintiff for taxes unlawfully collected by reason of failure of the Commissioner to allow deductions for bond discount.

As heretofore stated, the evidence establishes the plaintiff's contention that the fair market value of the assets received was less than the fair market value of the bonds and stocks issued in exchange therefor, but, in this case, where neither a cash nor arms-length transaction was involved such difference in values is not, in my opinion, a test for establishing a bond discount. Accepting the fair market value of the assets as being $4,084,587.60 the realities of the transaction were these. Bonds of the par value of $2,834,640 secured by first lien on all of the assets of the corporation were issued and delivered to the vendors, not at a discount, but for assets that were equal in value to more than the par value of the bonds. Common stock of the par value of $165,000 and preferred stock of the par value of $944,880 were issued and delivered. The books of the company reflected no deficiency in assets. Of course, the directors were acting within their legal rights in so valuing the assets, for the new corporation was a corporation organized under the laws of the State of Delaware where the law provides that the consideration for stock may be cash, labor, personal property, real property, etc., and that stock issued for such consideration is full-paid and not liable for any further payment and, in the absence of actual fraud, judgment of the directors as to the value of the consideration is conclusive.

The Arkansas-Missouri Power Corporation was not in the business of buying and selling stocks and bonds and was not directly concerned with the market value of its own securities. Its objectives were to obtain title to the assets of the public utility and to have the privilege of carrying on the business of the utility. It gained both of these objectives

by complying with the order of the Federal Court and the requirements of the Public Service Commissions of the States of Missouri and Arkansas.

I cannot possibly find in this transaction any basis for the position that there was a sale or issue of bonds at a discount and I must hold accordingly.

The foregoing memorandum will constitute the Court's Findings of Fact and Conclusions of Law and an order dismissing the actions of the plaintiff will be entered, copies of which counsel will shortly receive.

Dated this July 6, 1956.

THOMAS C. TRIMBLE
Chief Judge
United States District Court

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal, et al., former Collectors of Internal Revenue for the District of Arkansas,
Defendants.

Consolidated No. 1846

Order

(Filed in the U. S. District Court for the Eastern District of Arkansas on July 6, 1956)

On this July 6, 1956, the court having signed a memorandum which constitutes its Findings of Fact and Conclusions of Law now enters judgment in accordance with said Findings and Conclusions.

The court finds the issues in this case in favor of the defendants and that the plaintiff will take nothing by reason of the complaints filed herein and consolidated under the captioned number.

It is, therefore, by the court considered, ordered, and adjudged that the complaints of the plaintiff be and they are hereby dismissed and that the defendants have and recover of and from the plaintiff all costs herein expended.

THOMAS C. TRIMBLE
Chief Judge
United States District Court

Request for Admission of Facts

(Filed in the U. S. District Court for the Eastern District of Arkansas on January 23, 1951)

The plaintiff in the above styled causes requests the defendants therein to make the following admission of facts for the purposes of the trial of said actions only, and subject to all pertinent objections to admissibility which may be interposed at the trial.

(1) That the following statements are true, namely:

1. The Arkansas-Missouri Power Corporation, plaintiff in each of the above captioned causes, is a corporation organized under the laws of the State of Delaware as successor corporation to Arkansas-Missouri Power Company, and, as a foreign corporation, is authorized to do business in the State of Arkansas. The defendants, Roy Paschal and Horace E. Thompson, were each severally the Collector of Internal Revenue for the District of Arkansas, respectively, from May 16, 1940 to August 19, 1945, and from August 20, 1945 to May 3, 1948.

2. On March 15, 1940, the Arkansas-Missouri Power Corporation filed its corporation income and excess profits tax

return for the calendar year 1939 with the then Collector of Internal Revenue, Homer M. Adkins, and on said date, as part of the taxes shown due on said return, paid to the then Collector $10,640.42. Subsequently, on June 6, 1940, September 11, 1940, and December 11, 1940, paid the defendant, Roy Paschal as such Collector, $10,640.42, being the total tax reported and paid on said return of $42,461.66, which said amount was assessed on the Commissioner's March, 1940, list of assessments. A photostatic copy of said return is attached hereto as Exhibit "A."

On April 10, 1941, after an audit of said return, plaintiff paid to the defendant, Roy Paschal as Collector aforesaid, a deficiency assessment of $315 which was assessed on the Commissioner's April, 1941, assessment list, and in November, 1946, the Commissioner assessed a further deficiency of $61.41, which was paid to Collector Horace E. Thompson. On March 10, 1943, plaintiff filed with Roy Paschal, as Collector aforesaid, a claim for refund of $5,542.73 of the amounts so paid together with interest. The claim for refund was rejected December 16, 1946. Copies of said claim for refund and rejection are shown as Exhibits 1 and 2 of the complaint of the plaintiff's cause of action No. L. R. 1846, which was filed on December 15, 1948.

3. On March 8, 1941, plaintiff filed a tentative corporation income and excess profits tax return for the year 1940 with the defendant, Roy Paschal as Collector aforesaid. Its final return was filed on May 6, 1941, with said Collector and on March 7, May 1, June 5, and September 9, 1941, the plaintiff paid to the defendant, Roy Paschal, as Collector aforesaid, aggregate taxes for the year 1940 amounting to $51,859.19 as shown due on said return. A photostatic copy of said return is attached hereto as Exhibit "B." On July 18, 1942, plaintiff filed a claim for refund with the defendant, Roy Paschal, as Collector aforesaid, for refund of $51,859.19, with interest; and on or about March 27, 1947, said claim for refund was rejected, save and except as to

an item of $251.83 which was allowed as an overassessment. A copy of said claim for refund together with the Commissioner's rejection letter is shown as Exhibits 1 and 2 to the complaint of the plaintiff's cause No. L. R. 1889, which was instituted on or about March 18, 1949.

4. On March 14, 1942, the plaintiff filed its corporation income and declared value excess profits tax return for the year 1941 with the defendant, Roy Paschal, as Collector aforesaid. On that date and on June 8, September 3, and December 14, 1942, plaintiff paid in equal installments to the defendant, Roy Paschal, as Collector aforesaid, $180,235.95 combined income and excess profits tax which said amount was assessed on the Commissioner's March, 1942, list of assessments. After an audit, and on November 21, 1946, plaintiff paid to the defendant, Horace E. Thompson, as Collector aforesaid, a deficiency assessment on account of additional income tax earned for the year 1941, the sum of $1,839.93. On May 10, 1943, the plaintiff filed with the defendant, Horace E. Thompson, as Collector aforesaid, a claim for refund of $91,344.26 of the amount thus paid with interest. The claim for refund was rejected December 16, 1946. A copy of said claim for refund and the Commissioner's rejection letter are attached to the complaint of the plaintiff's cause No. L. R. 1847 and shown as Exhibits 1 and 2 thereto, which said cause was filed on December 15, 1948.

5. On or about February 23, 1935, the United States District Court for the Northern District of Illinois, Eastern Division, approved a petition filed February 21, 1931, of the Arkansas-Missouri Power Company, an Arkansas corporation (predecessor of plaintiff), for reorganization pursuant to Section 77B of Chapter VIII of the Federal Bankruptcy Act. The properties of the Arkansas-Missouri Power Company were located in Southeast Missouri and Northeast Arkansas, and consisted generally of electric generating plants, transmission lines, and local distribu-

tion systems, ice manufacturing plants, and a small water system, cash, and accounts receivable. More specific identification will be shown from the books and appraisals ordered made by the Court.

6. The Arkansas-Missouri Power Corporation was organized for the purpose of reorganization of the Arkansas-Missouri Power Company and took with the approval of the Bankruptcy Court title to said property as of May 1, 1937, under a Modified Plan of Reorganization, filed as Exhibit 1 hereto.

7. At the time of the reorganization, May 1, 1937, the reorganized Company, the plaintiff, entered upon its books Net Plant and other Assets aggregating $4,493,969.94, as follows: Depreciable property, net after accrued depreciation, $3,880,258.75; Land, $132,172.89; Cash and other Asset accounts, less liabilities, $115,955.06; Stock in East Missouri Power Company, $350,000; Salvage Materials, $15,583.24. The fair market value of the above described property, determined by the Commissioner of Internal Revenue for the purpose of computing depreciation for income tax purposes, as of May 1, 1937, at the time of the reorganization, was $4,084,587.60, or $409,382.34 less than the same property was entered on the books of the Company. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75, as entered upon the books to $3,470,876.41.

For this property the reorganized Company issued and delivered First Mortgage 5% Twenty Year Bonds of the aggregate Par value of $2,834,625; 18,897½ shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875; and 165,805 shares of Common Stock of the par value of $165,805. The reorganized Company as of the date of reorganization recorded Capital Surplus of $548,664.94. The aggregate fair market value of the first mortgage bonds, Preferred Stock and Common

Stock, based on bid and ask quotations ranging from May to August, 1937, for the stock and February to June, 1937, for the bonds, determined by the Commissioner of Internal Revenue for the purpose of computing depreciation for income tax purposes, was $4,084,587.60 as of May 1, 1937. The fair market value of the bonds was $2,409,444; of the Preferred Stock was $680,313.60; and of the Common Stock was $994,830, (totaling $4,084,587.60).

8: The reorganization thus consummated and carried out was a taxable reorganization under the income tax laws of the United States.

9. a. That $25,000 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired in June, 1937, by the payment in cash of par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

b. That $40,660 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1938 by the payment in cash in par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

c. That $62,215 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1939 by the payment in cash in par amount of the bonds redeemed, plus accrued interest for thirty days from the call date.

d. That $2,706,765 par amount of First Mortgage 5% bonds due January 1, 1957, were called for redemption and retired during the year 1940 by the payment in cash in the par amount of the bonds redeemed plus accrued interest for thirty days from the call date.

You are hereby requested to make such admission of facts as set forth above on or before February 10, 1951.

ARKANSAS-MISSOURI POWER CORPORATION
By: P. A. Lasley, Attorney
512 Pyramid Building
Little Rock, Arkansas

Defendants' Response to Plaintiff's Request for Admission of Facts

(Filed in the U. S. District Court for the Eastern District of Arkansas on February 7, 1951)

In answer to plaintiff's request for admission of facts filed and served on the defendants January 23, 1951, the defendants make response as follows: These admissions are made under the assumption and express agreement that all exhibits mentioned in the request are either attached to the original complaints or the original of these requests, or will be prior to the trial date.

The defendants admit the truth of paragraph 1 to 6, inclusive, and 8 to 9, inclusive, contained in the request for admissions.

As to paragraph 7 of the request for admissions, defendants admit the truth of the following portions of that paragraph:

> At the time of the reorganization, May 1, 1937, the reorganized Company, the plaintiff, entered upon its books net plant and other assets aggregating $4,493,969.94, as follows: Depreciable property, net after accrued depreciation, $3,880,258.75; Land, $132,172.89; Cash and other Asset accounts, less liabilities, $115,955.06; Stock in East Missouri Power Company, $350,000; Salvage Materials, $15,583.24. The fair market value of the above described property, determined by

the Commissioner of Internal Revenue for the purpose of computing depreciation for income tax purposes, as of May 1, 1937, at the time of the reorganization, was $4,084,587.60, or $409,382.34 less than the same property was entered on the books of the Company. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75, as entered upon the books, to $3,470,876.41.

For this property the reorganized Company issued and delivered First Mortgage 5% Twenty year bonds of the aggregate par value of $2,834,625; 18,897½ shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875; and 165,805 shares of Common Stock of the par value of $165,805. The reorganized Company as of the date of reorganization recorded Capital Surplus of $548,664.94.

The defendants deny the truth of the last two sentences of said paragraph for the reason that they are without information sufficient to form a belief as to the truth thereof; for the further reason that the defendants have no information as to what the fair market value of the respective securities was on the date in question; for the further reason that the figure $4,084,587.60 admitted as being the fair market value of the properties received upon the issuance of the bonds and other securities was not based upon bid and asked quotations but upon the value of the property. Defendants further aver that they cannot admit the truth of the said statement as to fair market value of the bonds, preferred stock and common stock upon the ground that the average bid and asked quotations on small lots of bonds and other securities over a period of several months after

their issuance is not a fair criterion of their fair market value as a whole at the time of the issuance thereof.

Dated 6th day of February, 1951.

/s/ JAMES T. GOOCH
United States Attorney
By G. D. Walker
Ass't U. S. Atty.

The following is a list and description of all the Exhibits Introduced.

Plaintiff's Exhibits

No. 1—Letter from W. E. Sandborn of Day & Zimmerman to J. E. Flanders dated December 5, 1935 confirming discrepancies in the Day & Zimmermann Appraisal Report (introduced by Witness Flanders).

No. 2—Fair Market Value of Physical properties of Arkansas Missouri Power Company acquired by Arkansas Missouri Power Corporation as of May 1, 1937 as determined by J. E. Flanders (introduced by Witness Flanders).

No. 3—Arkansas Missouri Power Company Electric Property Retirements, May 31, 1935 to May 1, 1937 (introduced by Witness Flanders).

No. 4—Modified Plan of Reorganization (Printed in full, R. 51) (introduced by Witness Newcomb).

No. 5—Certified copy of Resolution of the Council of City of Thayer, Missouri, dated August 18, 1936, notifying Arkansas Missouri Power Company to remove its facilities from the streets and public places of the City (introduced by Witness Newcomb).

No. 6—Arkansas Missouri Power Company Pro Forma Balance Sheet as at October 31, 1936, as presented in the Modified Plan of Reorganization (introduced by Witness Atkinson).

No. 7—Bid and Asked Prices reported by National Corporation Bond Summary, issue of June 1, 1937 and July 1, 1937, and of the National Monthly Stock Summary, issue of October 11, 1937 and June 10, 1937.

No. 8—Letter of Internal Revenue Service dated March 5, 1941 addressed to Arkansas Missouri Power Corporation.

No. 9—Day & Zimmermann, Inc., Engineers Report No. 3092 of Arkansas Missouri Power Company.

No. 10—Excerpts from the Day & Zimmermann Report No. 3092.

No. 11—Pages 59A, 59B, 59C and 59D of the Day & Zimmermann Report No. 3092.

No. 12—Excerpt from page 34 of the Day & Zimmermann Report No. 3092.

No. 13—Claim for Refund on Account of Overpayment of Taxes for year 1942, with schedule attached.

No. 14—(a) Photostatic copies of registered letter dated March 11, 1943, Check No. 1469 of Arkansas Missouri Power Corporation, receipt of Payment issued by Collector of Internal Revenue, letter dated April 13, 1943 from Company to Roy G. Paschal, and check No. 2122 of Arkansas Missouri Power Corporation dated April 12, 1943.

(b) Photostatic copies of check No. 3263 of Arkansas Missouri Power Corporation, receipt for payment dated June 15, 1943, and letter from Company dated June 10, 1943.

(c) Photostatic copies of check No. 5099 of Arkansas Missouri Power Corporation, receipt issued by Collector, and letter dated September 11, 1943.

(d) Photostatic copies of check No. 6665 of Arkansas Missouri Power Corporation, and letter dated December 6, 1943.

(e) Photostatic copies of check No. 7668 dated August 31, 1949 and letter of transmittal.

(f) Photostatic copies of check No. 7615 dated June 30, 1950 and letter dated July 12, 1950 from Collector.

(g) Copy of letter dated August 7, 1950 from Collector.

Defendant's Exhibits

Woodall's No. 1—Statement comparing basis of Properties Per Books as of May 1, 1937 with the basis set forth in the letter dated March 5, 1941 written by Revenue Agent.

Woodall's No. 2—Statement showing the assets and liabilities per Company books compared with Assets and liabilities as reflected by Agents of the Internal Revenue Service.

Woodall's No. 2-A—Calculation explaining Woodall's No. 2.

Defendant's Exhibits Attached to Stipulation:

No. 1—(a) Income and excess profits tax returns, Arkansas Missouri Power Company, 1937, long and short periods.

(b), (c), (d), (e) Income and excess profits tax returns for years 1937, 1938, 1939 and 1940, respectively.

No. 2—Mortgage Indenture of January 1, 1937, Arkansas Missouri Power Corporation to Continental Illinois Bank & Trust Company.

No. 3—(a), (b), (c), (d) Arkansas Missouri Power Corporation Annual Reports, years 1937, 1938, 1939 and 1940, respectively.

No. 4—Arkansas Missouri Power Corporation statement of sale of Common Stock of East Missouri Power Corporation and dividend record.

No. 5—Approval of Reorganization by Arkansas and Missouri Public Utilities Commissions, A and B.

No. 6—Claims for Refund attached to the pleadings.

No. 7—Registered 90 day rejection letter of June 13, 1946, for the calendar years 1939, 1940 and 1941.

PLAINTIFF'S EXHIBIT 4

Modified Plan of Reorganization
of
Arkansas-Missouri Power Company

RECEIVED
JAN 14 1937
Department of Public Utilities
By 10-73

BONDHOLDERS' COMMITTEE

Members of the Committee:

W. W. TURNER, Chicago, Illinois,
HAMILTON ALLPORT, Chicago, Illinois,
A. F. BERINGER, New York, New York,
JOHN GALLAGHER, Chicago, Illinois,
HAROLD W. McEVOY, New York, New York.

W. W. TURNER,
Chairman of the Committee,
120 South La Salle Street,
Chicago, Illinois.

HAMILTON ALLPORT,
Secretary of the Committee,
250 Board of Trade Building,
Chicago, Illinois.

CHAPMAN AND CUTLER,
Counsel for the Committee,
111 West Monroe Street,
Chicago, Illinois.

DEBENTUREHOLDERS' COMMITTEE

Members of the Committee:

MILTON FERGUSON, Chicago, Illinois,
R. L. PARKINSON, Chicago, Illinois,
J. A. SHANNON, Chicago, Illinois.

MILTON FERGUSON,
Chairman of the Committee,
39 South La Salle Street,
Chicago, Illinois.

J. A. SHANNON,
Secretary of the Committee,
Room 712, 39 South La Salle Street,
Chicago, Illinois.

TENNEY, HARDING, SHERMAN AND ROGERS,
Counsel for the Committee,
120 South La Salle Street,
Chicago, Illinois.

PREFERRED STOCKHOLDERS' COMMITTEE

Members of the Committee:

W. B. HALEY, Louisiana, Missouri,
W. E. AYDELOTT, Troy, Missouri,
A. C. KUNDERER, St. Peters, Missouri,
W. W. METZ, Bellflower, Missouri,
TONY GNADE, Old Monroe, Missouri.

W. B. HALEY,
Chairman of the Committee,
Louisiana, Missouri.

DEARMONT, SPRADLING & DALTON,
Counsel for the Committee,
Cape Girardeau, Missouri.

MOSES, KENNEDY, STEIN AND BACHRACH,
Counsel for Arkansas-Missouri Power Company
231 South La Salle Street,
Chicago, Illinois.

THIS PLAN HAS NEITHER BEEN APPROVED NOR DISAPPROVED BY THE COURT.

Arkansas-Missouri Power Company

Modified

Plan of Reorganization

GENERAL

This Modified Plan of Reorganization (herein referred to as the "plan") of Arkansas-Missouri Power Company (herein referred to as the "Company") constitutes a revision of a plan heretofore prepared and filed in proceedings for the reorganization of the Company now pending in the United States District Court for the Northern District of Illinois, Eastern Division (herein referred to as the "court"). It has been contributed to and is the result of negotiations between committees representing holders of the bonds, debentures and Preferred Stock of the Company, the holders of unsecured notes and parties interested in the Common Stock of the Company; and has been prepared with the cooperation of officials of the Company.

The contributors to the plan have approached the reorganization of the Company with the following objectives in mind:

First: The capital structure of the reorganized company should be such as to avoid future financial difficulties so far as the same can be foreseen and the securities to be issued should be based on present and reasonable expectations of earnings, adjusted as near as practicable to the report of Day & Zimmermann, Inc., Independent Engineers, in respect to the properties (which report was ordered by the court in reorganization proceedings hereinafter referred to) as to values, retirement reserves and maintenance expenditures.

Second: A proper distribution should be made to those entitled to participate in the reorganization based on the equities involved and taking into consideration in the case of Preferred Stockholders the value of their cooperation to the Company and its creditors.

Third: Security holders should receive a maximum return on their securities consistent with their respective interests to the extent that this will not jeopardize the operations of the reorganized company and continuity of its service.

ASSETS AND EARNINGS

The Company is engaged in the sale of electricity, water and ice in eight counties situated in the northeastern part of Arkansas and nine counties in the central and south central part of Missouri, embracing an area in excess of 11,000 square miles. It also owns all of the Common Stock of the East Missouri Power Company which furnishes electric service to thirty-seven communities located in territory northwest of St. Louis, Missouri.

There is attached hereto as Schedule 1 a summary of the values of the physical properties based upon the report of the engineers (the one above referred to), with certain modifications recommended by officials of the Company.

The value of the physical property of the East Missouri Power Company, as shown by its balance sheet (Schedule 2), corresponds closely as of October 31, 1936, with the value reported by Day & Zimmermann, Inc., in their recent appraisal of property values. The earnings of the East Missouri Power Company, applicable to its Common Stock, are shown in the earnings statement hereinafter referred to.

It is contemplated that a reserve for adjustments of assets acquired in reorganization in the amount of $310,832 will be set upon the books of the reorganized company.

There is attached hereto as Schedule 3 a balance sheet of the Company as of October 31, 1936, and a pro forma balance sheet as of that date reflecting the securities to be outstanding under the

Opposite is Plaintiff's Exhibit 4, "Modified Plan of Reorganization of Arkansas-Missouri Power Company," identified and introduced by Plaintiff's Witness Newcomb.

plan. Arthur Andersen & Co., Accountants and Auditors, have previously examined the accounts of the Company for the years ended December 31, 1932, 1933, and 1934, and the period ended August 31, 1935, and are now engaged in making an audit of the Company's accounts.

There is also attached, as Schedule 4, an earnings statement showing (a) the earnings of the Company (adjusted as indicated thereon) for the years 1933, 1934, and 1935. (b) Estimated earnings for the year ending December 31, 1936 (adjusted as noted thereon), based upon the earnings per books of the Company for the ten months ended October 31st and an estimate by the Company for the two remaining months of 1936.

OUTSTANDING SECURITIES TO BE DEALT WITH

The outstanding securities of the Company as of the date hereof according to information supplied by the Company are as follows:

1. Bonds

First Mortgage Thirty Year Sinking Fund Gold Bonds, due January 1, 1953 as follows:		
5% Bonds, principal amount	$ 32,000	
6% Bonds, principal amount	3,303,500	
7% Bonds, principal amount	444,020	
Total		$3,779,520

2. Debentures, Notes and Pending Claims

Ten Year 6½% Gold Debentures (unsecured) due May 1, 1935, principal amount	$ 787,600	
Notes Payable (unsecured), principal amount	386,500	
Total		**$1,174,100**

In addition to these items there remain pending unadjudicated in the proceedings a few claims involving a relatively small amount.

3. Stocks

12,859 shares 7% Preferred Stock, $100 Par Value	$1,285,900
Scrip for Preferred Stock	660
160,000 shares Common Stock	

The bonds above described (herein referred to as "First Mortgage Bonds of the Company") are secured by a first mortgage on substantially all the physical properties and franchises of the Company, executed by the Company to St. Louis Union Trust Company as Trustee, dated as of January 1, 1923, which mortgage will be hereinafter referred to as the "existing first mortgage." Interest on the bonds is unpaid from January 1, 1935.

The debentures and notes above listed are unsecured. Interest on the debentures is unpaid from November 1, 1934.

TRANSMISSION LINE CONSTRUCTION AND POWER CONTRACT

It has been necessary for the Company to make arrangements for additional power supply and to that end the Company has entered into a ten year contract, subject to the approval of the court and of the Arkansas Department of Public Utilities, for the purchase of its power requirements (in excess of generation from its existing plants) not exceeding 10,000 kilowatts and not less than 5,600 kilowatts. This contract provides for the construction by Arkansas Power and Light Company of the necessary transmission line extending its transmission system to a point adjacent to the Company's system and for the advance by this Company of the cost of such line, up to $200,000, such advance to be repaid with interest on deferred payments at the rate of 4½% per annum, by crediting the Company with all amounts due for power purchases in excess of $160,000 per year during each of the first five years of the contract and for all amounts due for power purchased thereafter until the entire amount of the advances, with interest, has been repaid. The Company contemplates the construction at a cost of approximately $140,000 of a transmission line (with necessary sub-station) connecting the Company's transmission system with the above line. It is estimated that the power purchases of the Company from Arkansas Power and Light Company during 1936 will aggregate approximately $190,000 and that these purchases will be increased after the completion of the proposed new line. If such proposed power contract is for any reason not carried out, it will be necessary for the Company to make other arrangements for additional power of such character as may be approved by the court.

SECURITIES TO BE ISSUED UNDER THE PLAN

1. Treatment of Bonds.

For each $1,000 principal amount of First Mortgage Bonds of the Company, accompanied by all interest coupons appertaining thereto, maturing on and after July 1, 1935, there shall be issued and delivered in exchange the following:

(a) $750 principal amount of First Mortgage 5% Bonds, dated January 1, 1937, and maturing January 1, 1957;

(b) $250 par value 6% Cumulative Preferred Stock;

(c) 6 shares of Common Stock;

(d) $15 Special Bond Coupon to be attached to said First Mortgage 5% Bonds, which coupon will be payable on or before January 1, 1940;

(e) $53 in amount of Cash Scrip which is hereinafter described, and

(f) $22 in cash.

The above items (d), (e) and (f) are equal to the amount of interest at the rate of 5% per annum on the new bonds from January 1, 1935 to December 31, 1936 and to dividends on the new 6% Cumulative Preferred Stock for the year 1936. If dividends on the new 6% Cumulative Preferred Stock accrue as of a date subsequent to January 1, 1937, cash equal to dividends between said date and the date of accrual will also be paid to parties receiving such stock.

Bonds of denomination of less than $1,000 will receive new securities on the same basis proportionately as above. Interest accrued and payable subsequent to January 1, 1937, on said First Mortgage 5% Bonds at the time of the delivery thereof will be paid in cash, the interest coupons so paid being detached and cancelled.

The First Mortgage 5% Bonds will be in denominations of $1,000, $500, $100, $50 and $25. Provision may be made that the $50 and/or $25 bonds may be fully registered and without interest coupons or registered as to principal and with interest coupons.

2. Treatment of Debentures and Notes Payable and Unsecured Claims

For each $100 of principal amount of existing debentures, accompanied by interest coupon maturing May 1, 1935, and for each $100 principal amount of Notes, there will be issued, in exchange, 10 shares of Common Stock. No distribution will be made on account of interest on said debentures and notes.

For each $100 of other unsecured claims which may be finally allowed by the court there will be issued 10 shares of Common Stock; provided, however, any such claim may be compromised or settled by cash payment approved by the court.

3. Treatment of Outstanding Preferred Stock

For each share of Preferred Stock of the existing Company, 2 shares of Common Stock will be issued in exchange. Scrip for Preferred Stock will be treated as if it consisted of the Preferred Stock deliverable therefor, provided claims on account of such scrip shall have been filed and allowed by the court.

4. Treatment of Outstanding Common Stock

For each 10 shares of the 160,000 shares of Common Stock of the existing Company there will be issued in exchange warrants to purchase 1 share of Common Stock at $9 per share on or prior to December 31, 1938, and thereafter and on or prior to December 31, 1941, at $10 per share.

(See later provisions for scrip in lieu of fractional shares of stock and special provisions for disposition of $20 bonds under heading of "Miscellaneous.")

There is attached hereto as Schedule 5 a chart showing distribution of the new securities.

Taxes, amounts due consumers and current accounts payable will be assumed by the reorganized company.

TERMS OF THE NEW FIRST MORTGAGE 5% BONDS AND THE SECURITY THEREFOR

The bonds to be issued will be dated as of January 1, 1937, will mature twenty years from date thereof, will bear interest at the rate of 5% per annum from the date thereof, payable semi-annually on January first and July first of each year, and will be redeemable in whole or in part at any time on thirty days' published notice at par plus accrued interest.

The reorganized company (which term is later herein defined) will execute its mortgage to The Continental Illinois National Bank and Trust Company of Chicago and some person resident of the State of Missouri (who will act as Co-trustee) to secure its First Mortgage 5% Bonds, which mortgage (herein referred to as the "new first mortgage") will constitute a lien on substantially the same properties as are now subject to the lien of the existing first mortgage (including any property acquired subsequent to the execution thereof) and in addition thereto will constitute a first lien on all of the Common Stock (except that directors' qualifying shares may be omitted) of East Missouri Power Company. The new first mortgage will permit the issuance of additional bonds (without limit as to the aggregate principal amount) on account of additional property or improvements, betterments, extensions or additions acquired or constructed subsequent to January 1, 1937, upon which the mortgage shall have been constituted a first lien subject only to current taxes, assessments not in default, taxes in course of contest and judgments pending on appeal not exceeding 1% of the amount of outstanding bonds, but only to the extent of 70% of the amount actually expended for or the fair value of (whichever may be less) the additional property or improvements, betterments, extensions or additions acquired or constructed, and if and only if it shall appear by a certificate of officers of the Company that the net earnings of the Company (not including dividends and interest received on investments), computed after deduction of all operating expenses and actual charges for maintenance, but without deduction for retirement reserves, for a period of twelve consecutive calendar months within the fifteen calendar months immediately preceding the date of application for the certification of bonds, have been at least equal to two times the sum of the annual interest charges on all bonds then outstanding and on bonds, the certification of which shall at the time be requested. In respect of property constructed by the reorganized company the fair value shall be determined as of the date of construction. Provision will be made for exclusion from additional property, against which bonds may be issued, of the power transmission line to be constructed by the Company. Provision will also be made for the inclusion as additional property on account of which bonds may be issued of the property at the time owned by East Missouri Power Company when, if and as the same shall be vested in the reorganized company and subjected to the lien of the new First Mortgage as a first lien thereon, subject only to items which are permitted in respect of other additional property as aforesaid, and it will also be provided that on account of the acquisition of such property bonds may be issued to the extent of the full amount actually expended in order to acquire such property but not in excess of 70% of the fair value of such property on establishment of earnings as compared with interest charges as provided above in respect of bonds issued against other additional property. Provision will be made that bonds may be issued in series with varying interest rates and it will be provided that bonds of one series may be issued for the purpose of refunding bonds of any other series. Sinking fund provisions which will appear in the mortgage are hereinafter outlined. The form of said mortgage will be such as will be approved by the court in proceedings now pending for the reorganization of the Company.

SINKING FUND

It will be provided in the new first mortgage that the Company shall maintain a sinking fund in which it shall deposit annually (prior to March 15th of each year commencing with the year 1938) in cash and/or in canceled new First Mortgage 5% Bonds (such bonds to be accepted at the principal amount thereof or cost thereof, whichever shall be the lesser) an amount equal to 25% of the available earnings for the preceding annual period, the first annual period to commence on January 1, 1937, and such available earnings to be computed after deducting from the income of the Company (not including dividends and interest received) all operating expenses, taxes, including accruals for federal taxes, charges for maintenance and provision for retirement reserves, interest for the pertinent period on indebtedness of the reorganized company and dividends accrued during such period on the outstanding Preferred Stock of the Company, but without any allowance for profit or loss arising through the sale of capital assets. Such moneys need not be paid or such bonds purchased out of earnings or profits of the Company if other funds of the Company shall be available for that purpose.

It will be provided that moneys accruing to said sinking fund shall be used by the Company or the Trustee for the purchase of bonds issued pursuant to the plan in the open market or towards the redemption of such bonds; also that the bonds so acquired shall be cancelled and delivered to the Trustee under the first mortgage securing said bonds and no additional bonds shall be issued on account of such cancellation.

MODIFICATIONS OF THE NEW FIRST MORTGAGE

Provision will be made for modification, from time to time, of any of the provisions of the new first mortgage by the written assents of the holders of two-thirds or more in amount of the bonds at the time outstanding; provided, always (a) that the obligation of the reorganized company to pay the principal of the outstanding bonds at their respective maturities, and the interest thereon, shall continue unimpaired, (b) that no modification of said indenture shall give to any bond or bonds thereby secured any preference over any other bond or bonds thereby secured, (c) that no waiver of any default shall extend to or affect any subsequent default or impair any rights consequent thereon, (d) that no waiver, modification or compromise of any rights which shall have been specially conferred upon the holders of any particular series of bonds shall be effective unless assented to by the holders of two-thirds in amount of the new bonds of such particular series, and (e) that no such modification shall authorize the creation of any lien prior to the lien of the said indenture upon any of the mortgaged and pledged property.

PREFERRED STOCK

The Preferred Stock of the reorganized company will have a par value of $50 per share (subject to any change approved by the court) and will entitle a holder thereof to receive cumulative dividends at the rate of 6% per annum prior to the declaration or payment of any dividends on the Common Stock. The holders of such stock will have no right to vote in the election of directors except that at such times as the accrued dividends on such Preferred Stock for a period of one year shall unpaid each holder shall be entitled to one vote for each share held in the election of directors. The Preferred Stock will be subject to redemption on thirty days' notice mailed to the holders thereof upon payment of the par value thereof plus accrued and unpaid dividends to the date of redemption and will entitle the holders thereof to receive the par value thereof (and no more) on voluntary or involuntary dissolution prior to any distribution to the holders of the Common Stock. The provisions in respect of such stock shall be such as may be approved by the court.

COMMON STOCK

The Common Stock of the reorganized company will have such par value or be without par value, all as may be approved by the court. Each share will be entitled to one vote on the election of directors and on all questions which may be submitted to the stockholders. The holders of such stock will not be entitled to receive any dividends unless all dividends accrued and unpaid on the Preferred Stock for all prior dividend periods shall have been paid or set aside for payment and unless dividends for the current dividend period shall have been declared and paid or set aside for payment. It will be provided that, on dissolution of the Company, subject to the prior rights of the holders of Preferred Stock which are stated above in the description of the Preferred Stock, all assets shall be distributed amongst the holders of the Common Stock.

CASH SCRIP

It is above provided that there may be distributed to the holders of First Mortgage Bonds of the Company cash scrip. Such scrip will be issued either by the reorganized company or by a trustee appointed by such company and will be payable solely from moneys which will be paid by such company in amounts equal to credits received by such company under the power contract hereinbefore referred to. Such scrip will be registered in the names of the respective holders and will specify the amount payable to such holder. It will not bear interest but provision will be made so that interest collected on the amounts represented by the outstanding scrip under the power construction contract will eventually be distributed to the holders of the scrip in addition to the amount of the scrip. It will be provided that distributions of cash received will be made to the holders of scrip from time to time when certain amounts shall be available for that purpose. Such scrip will be transferable only on the books to be kept by the issuer of the scrip. In case the transmission line construction and power contract shall not be entered into, the cash scrip will be paid from such sources and in such manner and at such times as may be approved by the court.

MANAGEMENT OF REORGANIZED COMPANY

The Board of Directors of the reorganized company will initially be seven in number, of which three will be composed of representatives of the holders of first mortgage bonds, debentures and Preferred Stock of the Company, and all of such directors will be subject to approval of the court.

METHOD OF EFFECTING THE PLAN

The Company has heretofore filed voluntary proceedings under Section 77B of the United States Bankruptcy Act, as amended, in the United States District Court in and for the Northern District of Illinois. W. W. Turner, Hamilton Allport, A. F. Beringer, John Gallagher and Harold W. McEvoy have been constituted as a Committee representing holders of the first mortgage bonds of the Company and said Committee will propose and endeavor to consummate the plan in such proceedings. The reorganization will be subject to the supervision of the court but will be effected under the direction of the said Committee.

The new securities to be issued as provided in the plan will be issued either by the present Company, or a new corporation will be organized under a similar name under the laws of such state as may be approved by the court, in which event such new corporation will acquire all of the assets of the Company and will issue such securities. References herein to "the reorganized company" will be deemed to refer to the present Company if the new securities are issued by such Company, or to the new corporation if securities are issued by such a corporation.

EXPENSES OF THE PLAN

All expenses incurred in carrying out the plan will be paid by the Company and will include (a) all costs and expenses incident to the reorganization including costs pertaining to the organization of a new corporation (if that be done) and the issuance and distribution of securities, as herein contemplated, (b) compensation and expenses of the trustees under the indentures now securing the first mortgage bonds of the Company and the debentures of the Company, (c) compensation and expenses of the Trustee under the indenture to be executed as herein provided, (d) compensation and expenses of the Committees representing first mortgage bonds, debentures and Preferred Stock of the Company and of their counsel and depositaries, (e) compensation of counsel for the Company, and (f) all other fees and items which the court may allow in the reorganization proceedings herein referred to, pursuant to authority contained in Section 77B of the United States Bankruptcy Act, as amended.

MISCELLANEOUS

Certain moneys have been deposited with the Trustee under the existing first mortgage and the same will be made available to the Company for use in payment of interest on the bonds to be issued under this plan. The existing first mortgage will be cancelled and released of record.

In such cases where the holder of securities of the Company pursuant to the foregoing provisions of the plan will be entitled to receive a fractional share of stock, fractional shares will not be issued and there will be issued in lieu thereof scrip of the Company entitling the holder thereof to receive full shares of stock when and as scrip shall be presented representing full shares of stock, additional scrip being delivered on account of any fractional shares remaining after the issuance of full shares of stock as aforesaid. Such scrip for Common Stock will provide that the holder shall have no rights thereunder except to receive shares of Common Stock as aforesaid and will further provide that the same shall become void if not exchanged for stock on or before eighteen months from the date thereof. Such scrip for Preferred Stock will provide that the holder thereof shall have no rights thereunder except to receive shares of Preferred Stock accompanied on delivery of any such shares with cash equal to accrued dividends thereon and will further provide that the same shall become void if not exchanged for Preferred Stock on or before five years from the date thereof.

A small amount of bonds of the Company is outstanding in the denomination of $20, and the Company will be authorized in its discretion to purchase and cancel any part or all of such bonds, thus eliminating the bonds so purchased from participation in the plan.

SCHEDULE 1

ARKANSAS-MISSOURI POWER COMPANY

PROPERTY ACCOUNT—Engineers—as of May 31, 1935, exclusive of Working Capital and Going Concern Value

	As Per Books October 31, 1936	Reproduction Cost New	Indirect or Overhead Costs	Total	Discount and Expense	Grand Total	Reproduction Cost Depreciated	Indirect or Overheads Depreciated	Total	Discount and Expense Depreciated	Grand Total Depreciated
Electric...	$5,921,613.81	$3,616,949.00	$496,553.00	$4,113,502.00	$287,946.00	$4,401,448.00	$3,260,111.00	$447,563.00	$3,707,674.00	$259,538.00	$3,967,212.00
Water.....	37,826.02	23,147.00	3,177.00	26,324.00	1,843.00	28,167.00	20,784.00	2,852.00	23,636.00	1,655.00	25,291.00
Ice.....	583,509.11	728,910.00	100,069.00	828,979.00	58,028.00	887,007.00	596,839.00	81,938.00	678,777.00	47,514.00	726,291.00
Total....	$6,542,948.94	$4,369,006.00	$599,799.00	$4,968,805.00	$347,817.00	$5,316,622.00	$3,877,734.00	$532,353.00	$4,410,087.00	$308,707.00	$4,718,794.00
				* 428,979.00					* 278,777.00		
				$4,539,826.00					$4,131,310.00		

*Ice Properties:

Due to the declining ice business, the Company has recommended setting up the net carrying values for this classification at $400,000 or $278,777 less than Engineers' Depreciated Valuation.

Depreciation:

	As set up by Engineers	As used in Pro Forma Balance Sheet
The difference between Reproduction costs new plus indirect or overhead costs	$4,968,805	$ 4,539,826
and Reproduction costs new plus indirect or overhead costs depreciated	4,410,087	4,131,310
	$ 558,718	$ 408,516

Not Used Nor Useful Property—(Not included in above):

Engineers' Reproduction Cost new as of May 31, 1935	$314,629
Less Engineers' Reproduction Cost new of property sold to October 31, 1936	27,449
Engineers' Reproduction Cost new of undisposed property	$287,180
Company estimated eventual salvage value as of May 31, 1935	$ 22,641
Less salvage realized to October 31, 1936	3,000
Company estimates salvage value of undisposed property as of October 31, 1936	$ 19,641

Campbell Electric Property:

By court order the Company on November 3, 1936, ceased operation of its electric plant in Campbell, Missouri, and a large part of such property is being dismantled and retired. This schedule includes such dismantled and retired property at a reproduction cost of $24,861 and at a depreciated value of $22,408. Proper adjustments will be made on the books of the new company in the plant and property account to reflect such losses, adjusted for amounts realized through salvage.

Luxora Water Property:

Negotiations are pending for the sale of the Luxora water property owned by the Company. This schedule includes such property at a reproduction cost of $26,324 and at a depreciated value of $23,636. If this sale is consummated, it will result in a reduction in the property account of the new company.

N. B.—This schedule does not include property of East Missouri Power Company.

SCHEDULE 2

EAST MISSOURI POWER COMPANY

BALANCE SHEET—October 31, 1936

ASSETS

PLANT, PROPERTY, RIGHTS, FRANCHISES, ETC.			$1,079,149.57
INVESTMENT IN PREFERRED STOCK OF PARENT COMPANY at cost			2,246.99
DEBT DISCOUNT AND EXPENSE IN PROCESS OF AMORTIZATION			12,721.90
PREPAID ACCOUNTS AND DEFERRED CHARGES			941.61
CURRENT ASSETS:			
Cash		$68,476.07	
Accounts and notes receivable	$27,121.52		
Less—Reserve for uncollectible accounts	4,660.98	22,460.54	
Material and supplies (net)		9,291.27	100,227.88
			$1,195,287.95

LIABILITIES

CAPITAL STOCK:			
7% cumulative preferred stock par value $100.00 per share redeemable at $105.00 per share—			
Authorized and issued 1000 shares	$ 100,000.00		
Less reacquired and held in treasury, 150 shares	15,000.00	$ 85,000.00	
Common—			
Authorized 15000 shares—no par value—			
Issued and outstanding—14547 shares		363,675.00	$ 448,675.00
FUNDED DEBT:			
First Mortgage 5% Gold Bonds Series A, due March 1, 1956			225,000.00
DEFERRED LIABILITIES—Customers deposits			1,666.28
CURRENT LIABILITIES:			
Accounts payable		$ 4,260.96	
Due affiliated companies		3,285.04	
Accrued taxes		15,156.12	
Accrued interest		1,887.50	
Accrued dividends on preferred stock		495.85	
Miscellaneous		848.97	25,934.44
RESERVES:			
Retirements, including $18,283.46 arising from appraisals in 1926		$182,877.57	
Contributions for extensions		13,977.17	196,854.74
CAPITAL SURPLUS, arising from appraisals			198,382.03
SURPLUS—Restricted for dividend purposes, to extent of $15,000.00 of re-acquired preferred stock at par, until such stock is sold or cancelled			98,775.46
			$1,195,287.95

SCHEDULE 3

ARKANSAS-MISSOURI POWER COMPANY

BALANCE SHEET—OCTOBER 31, 1936

PER BOOKS AND PRO FORMA GIVING EFFECT TO PROPOSED PLAN WITHOUT PROVISION FOR REORGANIZATION EXPENSES AND SUCH OTHER PAYMENTS AS MAY BE ORDERED BY THE COURT

ASSETS	Per Books	Pro Forma
PLANT, PROPERTY, ETC.:		
Electric	$5,921,613.81	$4,113,502.00
Water	37,826.02	26,324.00
Ice	583,509.11	400,000.00
Total	$6,542,948.94	$4,539,826.00 (1)
INVESTMENTS IN COMMON STOCK OF SUBSIDIARY, EAST MISSOURI POWER COMPANY	563,675.00	660,832.49
SALVAGE VALUE OF PROPERTY NOT USED OR USEFUL (Engineers' Reproduction cost new is $287,180.00)	—	19,641.00
DEBT DISCOUNT AND EXPENSE IN PROCESS OF AMORTIZATION AND OTHER DEFERRED DEBITS	330,793.71	—
MISCELLANEOUS INVESTMENTS, SPECIAL DEPOSITS, ETC.	28,982.81	28,982.81
PREPAID ACCOUNTS	2,672.42	2,672.42
CURRENT ASSETS:		
Cash—		
In bank and on hand	604,727.89	256,323
Funds appropriated for specific purposes	—	390,393.2
In sinking fund with bond and debenture trustees	3,500.91	—
Deposited with bond trustee for payment of bond interest	38,487.50	—
Receivables, less reserves for uncollectible accounts	94,189.47	94,189.47
Inventories	69,438.55	61,938.55
	$ 810,344.32	$ 802,844.32
	$8,279,417.20	$6,054,799.04

LIABILITIES	Per Books	Pro Forma
CURRENT LIABILITIES:		
Accounts payable	$ 43,403.17	$ 43,403.17
Accrued taxes	64,002.66	64,002.66
Cash distribution to holders of old bonds as provided in plan (Accrual to October 31, 1936)	—	50,078.64 (3)
	$ 107,405.83	$ 157,484.47
DEFERRED LIABILITIES:		
Cash scrip payable only out of repayment of advances to be made for power transmission line	$ —	$ 200,314.56 (3)
Special bond coupon payable on or before January 1, 1940	—	56,692.80 (3)
Consumers' deposits and interest accrued thereon	77,746.13	77,746.13
Miscellaneous deferred liabilities	25,735.14	8,522.93
	$ 103,481.27	$ 343,276.42
RESERVES:		
Retirement reserve	$ 246,493.99	$ 408,516.00 (1)
Reserve for deferred maintenance	—	120,000.00
Reserve for adjustment of assets acquired in reorganization	—	310,832.49
	$ 246,493.99	$ 839,348.49
SECURITIES AND NOTES OUTSTANDING AND ACCRUED INTEREST THEREON AND SURPLUS (DEFICIT) OF PRESENT COMPANY:		
Notes payable to affiliated company, including accrued interest of $46,260.41	$ 426,760.41	
First mortgage thirty-year sinking fund gold bonds, due January 1, 1953 —		
5% Series	$ 32,000.00	
6% Series	3,303,500.00	
7% Series	444,020.00	3,779,520.00
Ten Year Gold Debentures 6½% due May 1, 1935		787,600.00
Accrued interest on first mortgage bonds	$ 423,362.50	
Accrued interest on debentures	102,388.02	525,750.52
7% Cumulative Preferred Stock—par value $100 per share (12,859 shares), including $660.00 scrip		1,286,560.00
Common Stock—no par value—160,000 shares		1,165,000.00
		$7,971,490.93
Capital surplus		205,165.64
Surplus (deficit)		*444,320.46*
SECURITIES TO BE OUTSTANDING AND CAPITAL SURPLUS OF PROPOSED NEW COMPANY:		
First Mortgage 5% Bonds due January 1, 1957		$2,834,640.00
6% Cumulative Preferred Stock—$50 par value per share—18,897.6 shares		944,880.00
Common Stock (based on $1 par value)—		
To be issued and outstanding 165,805 shares		165,805.00
(16,000 shares to be reserved for exercise of warrants.)		
Capital surplus		769,364.66
	$8,279,417.20	$6,054,799.04

NOTE.—See attached page for footnote references.

SCHEDULE 3—Continued

ARKANSAS-MISSOURI POWER COMPANY

NOTE 1.—The plant, property, etc., as reflected in the pro forma balance sheet of $4,539,826 is the adjusted Engineer's reproduction cost new as of May 31, 1935, exclusive of discount and expense, working capital and going concern value. The adjustment thereto is on ice property in the amount of $428,979, the Engineers reporting a valuation of $828,979.

This account and the related accounts, the retirement reserve and capital surplus accounts, are subject to adjustment to reflect additions to and retirements of property since the date of the appraisal to October 31, 1936.

NOTE 2.—Funds appropriated for specific purposes include—

Estimated advances to be made in connection with the construction of transmission line	$ 200,314.56
Estimated construction cost of transmission line to company	140,000.00
Cash to be disbursed to holders of old bonds $83,149.44.—amount accrued to October 31, 1936	50,078.64
Total	$ 390,393.20

NOTE 3.—Holders of old bonds are to receive special bond coupon, cash scrip and cash in the amount of $340,156.80. This is equivalent to interest at the rate of 5% per annum on new bonds for the period January 1, 1935 to December 31, 1936 and to dividends on the new 6% cumulative preferred stock for the year 1936.

It is contemplated that the distribution will be on the following basis:

	Per Old $1000 Bond	Amount
Special bond coupon	$15.00	$ 56,692.80
Cash scrip	53.00	200,314.56
Cash	22.00	83,149.44
Total	$90.00	$ 340,156.80

The Pro Forma Balance Sheet includes the accrual for the above only to October 31, 1936.

SCHEDULE 4

ARKANSAS-MISSOURI POWER COMPANY

EARNINGS STATEMENT FOR YEARS ENDED DECEMBER 31, 1933, 1934 AND 1935 (AS ADJUSTED) AND ESTIMATED EARNINGS FOR YEAR 1936

	1933	1934	1935	1936-[4]
GROSS EARNINGS:				
Electric	$ 751,076.26	$ 803,095.45	$ 848,390.67	$ 982,454.46
Ice	136,735.80	176,720.72	142,946.19	162,371.66
Water (1933 and 1936 includes coal)	9,699.90	4,361.74	4,013.07	6,922.90
Other operating revenues	61.79	357.47	2,610.93	9,717.46
Total Gross Earnings	$ 897,573.75 [1]	$ 984,535.38 [1]	$ 997,960.86 [1]	$ 1,161,466.48
OPERATING EXPENSES AND TAXES:				
Operation	$ 458,790.22 [1]	$ 478,997.50 [1]	$ 506,105.38 [1]	$ 575,397.37
Maintenance	61,000.00 [2]	61,000.00 [2]	61,000.00 [2]	61,000.00
Taxes—state and local	74,438.26 [1]	79,345.41 [1]	83,699.34 [1]	84,677.30
Total Operating Expenses and Taxes	$ 594,228.48	$ 619,342.91	$ 650,804.72	$ 721,074.67
Net Earnings from Operations before Provision for Retirement	$ 303,345.27	$ 365,192.47	$ 347,156.14	$ 440,391.81
Other Income (net)	8,541.50 [1]	477.24 [1]	1,039.79 [1]	1,771.97
Net Earnings before Provision for Retirement	$ 294,803.77	$ 365,669.71	$ 348,195.93	$ 442,163.78
Provision for Retirement	130,345.46 [2]	130,345.46 [3]	130,345.46 [3]	130,345.46
Total Net Earnings	$ 164,458.31	$ 235,324.25	$ 217,850.47	$ 311,818.32
Net Amount Earned for Common Stock of Subsidiary East Missouri Power Company	17,356.00 [4]	4,488.11 [5]	12,527.25 [5]	34,915.51
	$ 181,814.31	$ 239,812.36	$ 230,377.72	$ 346,732.83

ESTIMATED EARNINGS AVAILABLE FOR PROPOSED NEW SECURITIES

Estimated Net Earnings shown above (1936)	$ 346,733.83
Interest on Consumers' Deposits	4,200.00
	$ 342,533.83
Taxes—Income:	
State	3,500.00
Federal	24,500.00
Federal surtax on undistributed profits	—
	$ 28,000.00
	$ 314,533.83
Annual Interest Requirements on Proposed 5% First Mortgage Bonds—Principal Amount $2,834,640 (Indicating interest would be earned 2.22 times)	141,732.00
	$ 172,801.83
Preferred Dividend Requirement on Proposed Issue of 6% Cumulative Preferred Stock—$50 Par Value—Book Value $944,880—18,897 6/10 shares—(Indicating dividends would be earned 3.05 times)	56,692.80
Balance for 165,895 Shares of Common Stock	$ 116,109.03

*No provision has been made for Federal surtax on undistributed profits.

Notes: [1]—For the years 1933 and 1934 the items of gross earnings, operating expenses, taxes, and other income net (except maintenance, provision for retirements, and subsidiary earnings) are taken from the audit reports made by Arthur Andersen & Co. for those years. For the year 1935 the same items, with the exception of maintenance, provision for retirements, and subsidiary earnings, are taken from the Company's records inasmuch as the last audit by Arthur Andersen & Co. was made as of August 31, 1935.

The actual maintenance expenditures for the years 1933, 1934, and 1935 were $46,610.87, $51,200.81, and $66,733.30, respectively, and the actual provisions for retirements for those years were $21,921.11, $90,933.32, and $99,900.46, respectively.

[2]—The report of the engineers recommends that the Company spend during the next 5 years $40,000 per annum on account of deferred maintenance and rehabilitation. The Engineers estimate normal maintenance expenditures to be at the rate of $61,000 per annum, after the expenditure heretofore mentioned, and after providing for an additional source of power supply. A contract for additional power covering the needs of the Company has been executed and awaits the approval of the Court and the Arkansas Department of Public Utilities. An estimated annual charge of $61,000 for maintenance is indicated for each of the years 1933, 1934, 1935 and 1936 and a reserve for deferred maintenance of $120,000 has been set up in the Pro Forma Balance Sheet. An adjustment with reference to these items may be made in the reserve for retirements at the time the books of the new company are set up.

[3]—Annual retirement provisions on electric and water depreciable property are to be made at the rates of 3% and 1½%, respectively, as ordered by the State of Missouri Public Service Commission. The annual retirement provision on ice depreciable property is to be made at the rate of 5% as recommended by the Engineers.

In the earnings statement, annual retirement provisions have been calculated as follows:

Electric 3% depreciable property of	$3,684,185.00	$ 110,525.55
Water 1½% depreciable property of	23,027.00	345.41
Ice 5% depreciable property of	389,490.00	19,474.50
Annual retirement provision		$ 130,345.46

[4] The earnings statement for the year ending December 31, 1936 has been derived by taking the actual results from operation as reported by the company for the ten months ended October 31, 1936 together with the estimated revenues and expenses as reported by the Company for the remaining two months of the year. Appropriate adjustments have been made to reflect the recommendations of the Engineers as to maintenance (subject to Note 2 above) and the order of the Missouri Public Service Commission and Engineers as to provision for retirement (subject to Note 3 above). These adjusted figures have been substituted for the actual and estimated expenditures and provisions as made by the Company.

[5]—There has been included in the income statement for each of the four years an amount reflecting the net earnings of the subsidiary company, East Missouri Power Company, after payment of Preferred Stock dividends, representing the amount applicable to the common stock of that company, but not distributed as Common Stock dividends.

N. B. On Schedule 1 reference is made to the sale of the Luxora water property and to the retirement of the electric property at Campbell, Missouri. The net earnings available for bond interest (after interest on consumers' deposits) for the year 1936 include $1,790 for the Luxora water property and a net loss of $1,646 for the electric property at Campbell.

SCHEDULE 5

ARKANSAS-MISSOURI POWER COMPANY

CHART SHOWING SECURITIES OF AND CLAIMS AGAINST PRESENT COMPANY AS OF OCTOBER 31, 1936 EXCLUSIVE OF INTEREST ACCRUED AND AMOUNTS OF NEW SECURITIES DISTRIBUTABLE THEREFOR

EXISTING SECURITIES							NEW SECURITIES DISTRIBUTABLE							
First Mortgage Bonds due January 1, 1953			6½% Debentures due May 1, 1935	Notes Payable	7% $100.00 par value Preferred Stock	Common Stock No Par	First Mortgage 5% Bonds due January 1, 1957	Special Bond Coupon	Cash Scrip	Cash	6% $50.00 par value Cumulative Pfd. Stock	Common Stock **	Percentage of Ownership of new Common Stock	Purchase Warrants for New Common Stock Exercisable January 1, 1937 to December 31, 1941
5% Series	6% Series	7% Series												
$ 32,000							$ 24,000	$ 480.00	$ 1,696.00	$ 704.00	$ 8,000	192 shs.		
	$ 3,303,500						2,477,625	49,552.50	175,085.50	72,677.00	825,875	19,821 "	13.68%	
		$ 444,020					333,015	6,660.30	23,533.06	9,768.44	111,005	2,664 "		
			$ 787,600									78,760 "	47.50%	
				$ 386,500								38,650 "	23.31%	
					$ 1,285,900							25,718 "	15.51%	
						160,000 shs.						None*	—	16,000*
$ 32,000	$ 3,303,500	$ 444,020	$ 787,600	$ 386,500	$ 1,285,900	160,000 shs.	$ 2,834,640	$ 56,692.80	$200,314.56	$ 83,149.44	$ 944,880	165,805 shs.	100.00%	16,000

(Does not include provision for scrip for $660 par amount preferred stock)

DISTRIBUTION TO PRESENT SECURITY HOLDERS IS ON THE FOLLOWING BASIS

per								
$ 1,000	Principal amount 1st Mortgage 5% Bonds due January 1, 1953	$750	$15.00	$53.00	$22.00	$250	6 shs.	
$ 1,000	1st Mortgage 6% Bonds due January 1, 1953	750	15.00	53.00	22.00	250	6 "	
$ 1,000	1st Mortgage 7% Bonds due January 1, 1953	750	15.00	53.00	22.00	250	6 "	
$ 1,000	Principal amount 6½% Debentures due May 1, 1935						100 "	
$ 1,000	Principal amount Notes Payable						100 "	
$ 1,000	Par Value 7% Preferred Stock						20 "	
160,000	Shares—no par Common Stock							16,000*

*Holders of existing Common Stock shall receive warrants entitling the bearers to purchase new Common Stock in the aggregate amount of 16,000 shares at the following prices:

$ 9.00 per share in the period from January 1, 1937 to December 31, 1938
$10.00 per share in the period from January 1, 1939 to December 31, 1941.
Thereafter, the warrants shall become void.

**Additional shares of Common Stock may be issued and distributed to holders of claims adjudicated in the reorganization proceedings.

Stipulation

(Filed in the U. S. District Court for the Eastern District of Arkansas on June 25, 1956)

It is hereby stipulated and agreed by and between the parties hereto by their respective attorneys that the following facts shall be taken as true for the purposes of these actions and that the documents attached hereto are true copies of the originals of which they purport to be copies, and that the parties hereto waive all formalities as to the introduction of the copies attached in lieu of the originals or certified copies. The statements of fact herein made and the documents attached hereto may be read in evidence, subject, however, to the objections of either party with respect to any phrase, sentence, paragraph of any document or to the document or statement as a whole as to their relevancy and materiality, but no objection shall be taken as to the form in which the offering is made.

1. Attached hereto and marked Plaintiff's Exhibit 7 is one sheet of paper containing a true statement of the Bid and Asked prices reported by the National Corporation Bond Summary in its issue of June 1, 1937 and July 1, 1937, with respect to First Mortgage 5% Bonds due 1957, Arkansas Missouri Power Corporation, and the bid and asked prices shown in the National Monthly Stock Summary issued October 11, 1937, and June 10, 1937 with respect to Preferred Stock of the par value of $50 and Common Stock of the par value of $1 of the Arkansas Missouri Power Corporation.

2. Attached hereto and marked Plaintiff's Exhibit 8 is a photostatic copy of a letter and like copies of three sheets attached thereto dated March 5, 1941 addressed to Arkansas Missouri Power Corporation and signed by W. A. Holt, Agent in Charge, Oklahoma City, Oklahoma.

3. As Plaintiff's Exhibit 9 is filed a bound volume entitled: "Report No. 3092 of the Arkansas Missouri Power

Company to Arkansas Missouri Power Company, Blytheville, Arkansas, Day & Zimmermann, Inc., Engineers," which, as reflected on page 1 thereof is dated at Philadelphia, Pa., August 12, 1935, transmitted to the President of the Arkansas Missouri Power Company under letter of August 26, 1935.

4. Attached hereto and marked collectively Plaintiff's Exhibit 10 are excerpts from the Report, Exhibit 9, consisting of eight sheets.

5. As Plaintiff's Exhibit 11, it offers pages 59A, 59B, 59C and 59D of the Day & Zimmermann, Inc., Report, Exhibit 9, which have been accurately copied and are reflected in Plaintiff's Exhibit 2 on pages 16, 17, 18 and 19, respectively.

6. As Plaintiff's Exhibit 12, it offers that portion of page 34 of the Day & Zimmerman, Inc., Report, quoted by Witness Flanders in his deposition on page 58. A copy of the quotation is attached hereto.

7. Attached hereto as Plaintiff's Exhibit 13 is a photostatic copy of the plaintiff's claim for refund on account of alleged overpayment of taxes for the taxable year 1942 together with Schedule A attached thereto and as a part of said exhibit there is attached a copy of a letter transmitting said claim.

8. Attached hereto as Plaintiff's Exhibit 14 are the following:

(a) Photostatic copies of a registered letter dated March 11, 1943; of check No. 1469 of Arkansas Missouri Power Corporation for $627.64 together with endorsements thereon; of receipt for payment issued by the Collector of Internal Revenue dated March 18, 1943; of a letter dated April 13, 1943 from F. E. Atkinson, Auditor, to Roy G. Paschal; and of check No. 2122 of Arkansas Missouri Power Corporation dated April 12, 1943 in the amount of $8,064.40.

(b) Photostatic copies of check No. 3263 of Arkansas Missouri Power Corporation dated June 7, 1943 in the amount of $32,810.84, together with endorsements thereon; of receipt for payment in the amount of $45,899.24 dated June 15, 1943; and of letter dated June 10, 1943 from F. E. Atkinson, Auditor, covering the remittance mentioned in the receipt.

(c) Photostatic copies of check No. 5099 dated September 10, 1943 in the amount of $786.74 together with endorsements thereon; and of receipt issued by the Collector in the amount of $45,899.24, together with letter dated September 11, 1943.

(d) Photostatic copies of check No. 6665 for $45,899.24 together with endorsements thereon dated December 2, 1943; and of letter dated December 6, 1943 from F. E. Atkinson to the Collector.

(e) Photostatic copies of check No. 7668 dated August 31, 1949 in the amount of $56,498.12 together with endorsements thereon and letter transmitting the check.

(f) Photostatic copies of check No. 7615 in the amount of $16,687.57 dated June 30, 1950 together with endorsements thereon and letter dated July 12, 1950 signed by W. D. Self, Acting Collector, by Winbourn B. Witt, Assistant Chief, Comptroller's Division.

(g) Copy of a letter dated August 7, 1950 from W. D. Self, Acting Collector, by Winbourn B. Witt, Assistant Chief, Comptroller's Division.

Attached hereto as Defendants' exhibits are the following:

1. The following income and excess profits tax returns:

(a) Arkansas-Missouri Power Company, 1937, long and short periods;

(b) Arkansas-Missouri Power Corporation, 1937;

(c) Arkansas-Missouri Power Corporation, 1938;

(d) Arkansas-Missouri Power Corporation, 1939;

(e) Arkansas-Missouri Power Corporation, 1940.

2. Mortgage Indenture of 1-1-37, Arkansas-Missouri Power Corporation to Continental Illinois Bank & Trust Company securing bond issue of $2,834,640.

3. Arkansas-Missouri Power Corporation annual reports, 1937, 1938, 1939, and 1940.

4. Arkansas-Missouri Power Corporation statement of sale of Common Stock East Missouri Power Corporation and dividend record during the period of ownership.

5. Approval of Reorganization by Arkansas and Missouri Public Utilities Commissions, A and B.

6. Claims for Refund attached to the pleadings.

7. Registered 90 day rejection letter of June 13, 1946, for the calendar years 1939, 1940 and 1941.

Dated this 25 day of June, 1956.

All exhibits referred to in the Stipulation are omitted from the Printed Record, except Plaintiff's Exhibit 8 and Defendants' Exhibits 4, 5-A, 5-B-1 and 5-B-2.

Plaintiff's Ex. 8:

TREASURY DEPARTMENT
Internal Revenue Service
Oklahoma City, Oklahoma
March 5, 1941

Arkansas-Missouri Power Corporation,
Blytheville, Arkansas.

In re: Income Tax, Year 1939

Sirs:

Your protest dated December 13, 1940, against the adjustment in income tax liability set forth in my letter dated November 15, 1940, has been carefully considered by this office, which has reached the conclusions shown in the accompanying statement with respect to the exceptions which you have presented.

IF YOU AGREE to the revised adjustment, the enclosed form of waiver should be executed and forwarded to this office.

IF YOU DO NOT AGREE to the adjustment indicated, a hearing in this office will be arranged upon your written request; or should you desire to have this matter referred to the Technical Staff of the Bureau of Internal Revenue, Southwestern Division, Okla. City, Okla., for hearing by that office prior to the issuance of the final notice of deficiency, arrangements will be made accordingly upon your written request. Otherwise, unless you should either pay the deficiency in tax (together with any penalties which may be due) to the collector of internal revenue, or execute and file with this office the form of waiver enclosed with this letter, final determination of tax liability will be made and a notice of deficiency will be sent you in accordance with the privisions of law applicable to the assessment and collection of tax deficiencies.

In case you request a hearing by the Technical Staff, your request will be referred to that office, which will communicate with you regarding the matter. You are advised, however, that the Technical Staff will not consider substantial issues or important evidence unless previously presented to this office.

An additional period of fifteen days from the date of this letter will be allowed for such action as you may wish to take prior to the issuance of the statutory notice.

Respectfully,

W. A. HOLT,

Internal Revenue Agent in Charge,
301-313 Federal Building.

Enclosures :

Statement.

Form of waiver.

Arkansas-Missouri Power Corporation

Blytheville, Arkansas

STATEMENT

Year Ended December 31, 1939

Net Income

Net income disclosed by revenue agent's report	302,158.94
Adjustment for depreciation disallowed	32,045.44
Net income corrected	270,113.50

COMPUTATION OF TAX

Net income		270,113.50
Less: Interest on U. S. obligations		750.00
Adjusted net income		269,363.50
Tentative tax at 19%		51,179.07
Less: 14.025 Percent of credit for dividends received	3,570.38	
2½ Percent of the dividends paid credit	4,732.01	8,302.39
Total tax		42,876.68
Tax previously assessed		42,561.68
Additional tax to be assessed		315.00

Explanation of Adjustment to Revenue Agent's Report

Revenue agent's adjustment of depreciation sustained is reversed and it has been concluded to recognize the deductions claimed in your return for 1939 as representing a reasonable depreciation sustained for such taxable year. In reaching this conclusion, the following adjustments are determined in connection with your depreciable base:

The reorganization of the Arkansas-Missouri Power Company into Arkansas-Missouri Power Corporation under Sections 77A and 77B of the National Bankruptcy Act on April 28, 1937 does not meet the requirements of a nontaxable reorganization as defined by Section 112(g) of the Revenue Act of 1936.

(A) There was no attempt to consolidate or merge under the corporation laws of the United States or a State.

(B) Consideration was not solely voting stock since new bonds and preferred stock were also received.

(C) The old corporation or its stockholders were not in control of the new company as defined in Section 112(h) of the Revenue Act of 1936, immediately after the transfer of the assets.

Therefore, a gain or loss is recognized to the old company, its bondholders, and stockholders upon their exchanges in accordance with the provisions of Section 112 (a) of the Revenue Act of 1936.

The basic cost of the depreciable property of the new corporation as of May 1, 1937, is determined as follows:

Consideration Paid in Bonds & Stock

		Market Value May 1, 1937 Per Unit	Total Value
1st Mortgage Bonds	$2,834,640.00	85	$2,409,444.00
6% Cumulative Preferred Stock	944,880.00	36	680,313.60
Common Stock	165,805 Shares	6	994,830.00
Total market value May 1, 1937 of Bonds and Stock issued			$4,084,587.60

Assets Acquired:

Miscellaneous assets	$ 15,583.24
Investments	350,000.00
3% H. O. loan bonds	25,382.81
Cash	612,590.96
Net receivables	145,070.49
Inventories	127,971.59
Prepayments	3,897.74
Deferred debit	448.16
	$1,280,944.99

Liabilities Acquired:			
Accounts payable	$ 92,962.55		
Accrued liabilities	371,691.61		
Miscellaneous liabilities	334,752.53	799,406.69	481,538.30
Total cost of fixed property			$3,603,049.30
Total cost of nondepreciables (land, etc.)			132,172.89
Total cost depreciable property			$3,470,876.41

Recommended Set-Up of Depreciable Property May 1, 1937:

Utility	Cost Per Return Depreciables	Percent	Reserve	Adjusted Cost
Electric	$3,691,061.87	80.959	$ 881,072.29	$2,809,989.58
Water	25,710.00	.564	6,137,98	19,572.02
Ice	842,398.97	18.477	201,084.16	641,314.81
Total	$4,559,170.84	100.	$1,088,294.43	$3,470,876.41
Nondepreciables	132,172.89			132,172.89
Total Fixed Capital	$4,691,343.73			$3,603,049.30

The adjustment of the depreciation reserve to $1,088,-294.43 as of May 1, 1937 allows you to continue the depreciable base claimed in your returns for the years 1937, 1938 and 1939, allows depreciation to be accumulated from May 1, 1937 to December 31, 1939 as reflected by your returns, eliminates the necessity of adjusting retirements, and, at the same time, permits you to recover only the actual recommended base of the assets as of May 1, 1937.

Defendants' Exhibit 2 is a copy of the Mortgage Indenture executed by the Arkansas-Missouri Power Corporation (the appellant) to the Continental Illinois National Bank and Trust Company of Chicago, Illinois, and an individual, as Trustees, dated as of January 1, 1937, conveying all property, real, personal and mixed, which the appellant then owned and all which it might thereafter acquire, including all the issued and outstanding Common Stock of East Mis-

souri Power Company, as security for the First Mortgage 5% twenty year Bonds dated as of January 1, 1937, due January 1, 1957, in the amount of $2,834,625; with the following provisions on pages 29 and 30:

"Saving and excepting, however, all accounts receivable, bills receivable, cash on hand and in bank, materials and supplies, all commodities constituting the whole or part of any stock of merchandise kept for sale, contracts and operating agreements with other companies, leases and leasehold interests, and all shares of stock, bonds and other securities not specifically transferred or assigned to or pledged with the Trustees hereunder (other than stocks, bonds and other securities herein specifically agreed to be so transferred, assigned or pledged); provided, however, and it is hereby expressly agreed, that upon the happening of an event of default as specified in Section 9.01 hereof, all the following property then owned by the Company, viz.: materials and supplies, all commodities constituting the whole or part of any stock of merchandise kept for sale, contracts and operating agreements with other companies, leases and leasehold interests shall forthwith become and be subject to the lien of this Indenture, and each of them or the evidences thereof shall forthwith be delivered by the Company to the Trustees.

When and as acquired by the Company from Arkansas-Missouri Power Company that certain power line now under construction by Arkansas-Missouri Power Company extending from Blytheville, Arkansas, southerly to a point in the State of Arkansas on the south line of Township Thirteen North, and all easements, real estate and other rights by virtue of which said power line is maintained or upon which such power line shall be situated. The Company covenants that it will acquire said property from said Arkansas-Missouri Power Company within a reasonable time after the completion of the construction of said power line and the termination of all condemnation suits or other steps deemed advisable to be taken by Arkansas-Missouri Power Company in respect of said power line and rights in respect of the erection or maintenance thereof, free and clear of all liens prior to this Indenture except taxes and assessments which are not due and contested liens

permitted by Section 4.04 hereof. When and as said property shall be acquired, the Company agrees that it will cause its President or one of its Vice Presidents to file with the Trustee a certificate to the effect that said property has been acquired by the Company free and clear of all prior liens except as aforesaid and upon the filing of such certificate the Company shall be deemed to have complied with said covenant.

FURTHER PROPERTY CONVEYED TO TRUSTEES:

Also any and all property which may from time to time after the date of this Indenture by delivery or by writing of any kind be conveyed, mortgaged, pledged, assigned or transferred to the Trustees by the Company or by any person or corporation to be held as part of the trust estate; and the Trustees are hereby authorized to receive any such property and any such conveyance, mortgage, pledge, assignment and transfer, as and for additional security hereunder, and to hold and apply any and all such property subject to and in accordance with the terms of this Indenture.

All of the premises, property and franchises of whatever character, or wherever situated, at any time subject to the lien hereof are herein sometimes collectively referred to as the 'trust estate'."

Defendant's Ex. 4 to Stipulation:
Arkansas-Missouri Power Company
Arkansas-Missouri Power Corporation
Dividends Received from East Missouri Power Company
For the Years 1937 to 1941, Inclusive
and Sale of Common Stock in 1945

	Year	Amount
Dividends Received	1937	$25,457.25*
	1938	25,457.25
	1939	25,457.25
	1940	25,457.25
	1941	None

*Includes dividends in amount of $4,120.16 on earnings prior to May 1, 1937 which was credited to investment in

common stock of East Missouri Power Co., because the investment in Common Stock of East Missouri Power Co. was recorded on the books of Arkansas-Missouri Power Corporation at the book value of the common stock as at May 1, 1937.

Cash received from sale on June 7, 1945 of Common Stock of East Missouri Power Co.	$600,000.00
Cost of stock to predecessor, Arkansas-Missouri Power Company	563,675.00
Net profit as per Income Tax Return	$ 36,325.00

Defendant's Ex. 5-A to Stipulation:

State of Arkansas

Department of Public Uilities

Present: P. A. Lasley, Chairman; Joe Bond, T. G. Seal, Commissioners.

At a session of the Department of Public Utilities held in Little Rock, Arkansas, on January 8, 1937.

No. 73

In re: Application of Arkansas-Missouri Power Company to the Department of Public Utilities of Arkansas for Authorization of a Plan of Reorganization.

Order

This matter is before the Department on the application of Arkansas-Missouri Power Company and W. W. Turner, Hamilton Allport, A. F. Beringer, John Gallagher, and Harold W. McEvoy, constituting a committee organized to represent First Mortgage Thirty Year Sinking Fund Gold Bonds of Arkansas-Missouri Power Company.

The said Arkansas-Missouri Power Company is now under the jurisdiction of the United States District Court in and for the Northern District of Illinois, Eastern Division, pursuant to proceedings for reorganization under Section

77B of the United States Bankruptcy Act, as amended. There is now pending before said court a modified Plan of Reorganization of Arkansas-Missouri Power Company which proposed plan has been filed with this Department.

The said Arkansas-Missouri Power Company owns and operates electric, water, and ice properties in the States of Arkansas and Missouri and also owns all of the Common Stock of East Missouri Power Company. Full information in respect to the property, balance sheet and earnings are disclosed by the schedules attached to the said modified Plan of Reorganization and information as to the character of the securities to be issued are set forth in said modified Plan of Reorganization. The securities to be issued will consist of:

$2,834,640 principal amount of new First Mortgage 5% Bonds, due January 1, 1957, with a special bond coupon in the sum of $56,692.80.

Cash scrip payable from limited sources as provided in the plan in the amount of $200,314.56,

6% Cumulative Preferred Stock having par value of $944,888.00.

165,805 shares of Common Stock and Stock Purchase Warrants for approximately 16,000 shares of Common Stock.

The securities to be issued are to be used for the purpose of retiring $3,779,520 principal amount of outstanding bonds, approximately $1,174,100 in amount of unsecured indebtedness and approximately $1,285,900 par amount of Preferred stock.

The annual interest obligations on the funded indebtedness which will be outstanding after consummation of the plan will be $141,732. The present annual fixed interest charges of the Arkansas-Missouri Power Company will be substantially reduced.

The Department is asked to issue its order or certificate

1. Approving the modified Plan of Reorganization submitted herewith as to the public interest therein and the fairness thereof.

2. Finding that the modified Plan of Reorganization is consistent with the public interest;

3. Authorizing the issue of stocks and bonds in the amounts provided by the modified Plan of Reorganization and the execution of all instruments contemplated by the modified Plan of Reorganization;

4. Determining that the amount of stocks and bonds to be issued under the modified Plan of Reorganization does not exceed the fair value of the property of the issuer of such securities; and

5. Authorizing a transfer of the properties and franchise of Arkansas-Missouri Power Company to a new corporation formed under the modified Plan of Reorganization if the organization of such new corporation shall be effected in order to consummate the modified Plan of Reorganization.

The modified Plan of Reorganization can be consummated through the proceedings for reorganization under Section 77B of the United States Bankruptcy Act only upon confirmation of the court in which such proceedings are pending and only upon the securing of the requisite acceptance as required by said Section.

After consideration of said modified Plan of Rorganization and the schedules thereto attached, it is ordered.

1. That the said modified Plan of Reorganization is hereby approved as to the public interest therein and the fairness thereof and it is hereby found that said modified Plan of Reorganization is consistent with the public interest;

2. That the amount of securities to be issued under the modified Plan of Reorganization does not exceed the fair value of the property involved;

3. That the securities in amount provided by the modified plan and the execution of instruments provided by said modified plan are hereby authorized;

4. That it is hereby found that the property to be paid for by the issuance of securities in accordance with the modified plan is reasonably required for the purpose of effecting a reorganization of Arkansas-Missouri Power Company; and

5. That the transfer of properties and franchises of Arkansas-Missouri Power Company to a new corporation formed under the modified plan if the organization of such new corporation shall be ordered by the court having supervision of Arkansas-Missouri Power Company.

Provided always that the foregoing is subject to the following provisions:

A. Nothing herein contained shall be deemed to constitute a finding of the value of the property of the Arkansas-Missouri Power Company for rate making purposes; and

B. It is understood that there will hereafter be filed with the Department a copy of all instruments to be executed in connection with the consummation of the plan; and

C. That the amount of fees of the Department payable in connection with authorization herein made shall be paid prior to the issuance of any securities.

Dated this 8th day of January, 1937.

By order of the Department of Public Utilities of Arkansas.

BERNICE C. GENTRY
Secretary

Defendant's Ex. 5-B-1 to Stipulation:

State of Missouri
Public Service Commission

At a Session of the Public Service Commission held at its office in Jefferson City on the 10th day of January, 1936.

Case No. 9069

In the Matter of the Application of Arkansas-Missouri Power Company for authorization of a Plan of Reorganization.

Order

The petition of the Arkansas-Missouri Power Company having been filed with this Commission requesting an order of approval of a Plan of Reorganization as provided by the provisions of Sections 5195, 5196 and 3201 of the Public Service Commission Law, and the Commission having heard proof and argument in explanation and in support of the issuance of such order of approval of said Plan of Reorganization, and the Commission on the date hereof having made and filed its report containing the findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof; now, upon due consideration,

It is,

Ordered: 1. That the Commission hereby authorizes the reorganization of the Arkansas-Missouri Power Company under the Plan of Reorganization submitted in this case.

Ordered: 2. That the Commission hereby consents to and authorizes the acquisition and holding by the Reorganized Company of the property and franchises of the present Arkansas-Missouri Power Company, including the stock of the East Missouri Power Company, and hereby consents to and authorizes the execution and delivery by

the Reorganized Company of a mortgage to secure aggregate amounts of bonds, as provided in the said Plan of Reorganization, and hereby consents to and authorizes the mortgaging and conveying in trust thereunder any or all of its property, stocks and franchises or other properties at any time owned or acquired.

Ordered: 3. That the Reorganized Company may upon application to the Commission issue stock, bonds and debentures of the tenor described in the said Plan of Reorganization, subject, however, to the approval of the Commission as to the form of said stock certificates, bonds and debentures and the mortgages, indentures or other documents made in connection therewith.

Ordered: 4. That allowances for retirement accruals shall be based upon the engineers' estimate of the depreciable property of the Company as at May 31, 1935 and subsquent depreciable net additions and betterments to such property. The accrual for electric property shall be at the rate of 3 per cent and the accrual for the water property shall be at the rate of 1½ per cent.

Ordered: 5. That the Commission reserve jurisdiction of the subject matter and the parties hereto for the purpose of entering such additional or supplemental order or orders herein as the facts may from time to time warrant, and that this application be continued for such further action.

Ordered: 6. That nothing herein contained shall be deemed to be finding of value for the purpose of fixing rates or for any other purpose than for the purposes herein mentioned and described.

Ordered: 7. That the applicant herein shall furnish the Commission certified copies of any order or orders made in reference to a said Plan of Reorganization by the United States Court for the Northern District of Illinois.

Ordered: 8. That this order shall take effect on this date and that the Secretary of the Commission shall forthwith serve on all parties interested herein a certified copy of this order.

By the Commission,

ROBERT E. HOLLIWAY,
Secretary

State of Missouri

Office of the Public Service Commission

I have compared the preceding copy with the original on file in this office, and I do hereby certify the same to be a correct transcript therefrom and of the whole thereof.

Witness my hand and seal of the Public Service Commission, at Jefferson City, this 10th day of January, 1936.

/s/ ROBERT E. HOLLIWAY

Before the Public Service Commission
Of the State of Missouri
Case No. 9069

In the Matter of the Application of Arkansas-Missouri Power Company for Authorization of a Plan of Reorganization.

Supplemental Report and Order No. 1

This Commission, on January 10, 1936, entered its report and order authorizing the reorganization of the Arkansas-Missouri Power Company, an Arkansas corporation licensed in Missouri, under a Plan of Reorganization in bankruptcy proceedings.

The Company, on January 13, 1937, filed an application asking that a Modified Plan of Reorganization be substituted for the Plan of Reorganization in the order referred

to and that said order shall relate to the said Modified Plan of Reorganization.

The Arkansas Commission has approved the said Modified Plan of Reorganization and this Commission deems it necessary and appropriate in the public interest to do likewise.

It is, therefore,

Ordered: 1. That the said Modified Plan of Reorganization shall be substituted for the Plan of Reorganization heretofore filed with the Commission and that the said order entered on January 10, 1936, shall relate to the said Modified Plan of Reorganization.

Ordered: 2. That the said report and order issued herein on January 10, 1936 shall remain unchanged as then issued except as hereinabove provided.

Ordered: 3. That this order shall take effect on this date and that the Secretary of the Commission shall serve certified copies of the same on all interested parties.

By the Commission,
ROBERT E. HOLLIWAY,
Secretary

Seal

Hargus, Chr., Boyer, Hortoni and Ferguson, CC, Concur, Anderson, C. absent.

Dated at Jefferson City, Missouri, this 14th day of January, 1937.

State of Missouri

Office of the Public Service Commission

I have compared the preceding copy with the original on file in this office, and I do hereby certify the same to be a correct transcript therefrom and of the whole thereof.

Witness my hand and seal of the Public Service Commission, at Jefferson City, this 14th day of January, 1937.

/s/ ROBERT HOLLIWAY

Defendant's Ex. 5-B-2 to Stipulation:

Before the Public Service Commission

Of the State of Missouri

Case No. 9069

In the Matter of the Application of Arkansas-Missouri Power Company for authorization of a Plan of Reorganization.

Order Approving the Issuance of Securities of Arkansas-Missouri Power Corporation Organized Pursuant to a Plan of Reorganization of Arkansas-Missouri Power Company and Authorizing Arkansas-Missouri Power Corporation to Acquire and Hold Certain Stock of East Missouri Power Company and Authorizing Arkansas-Missouri Power Company to Convey, Assign and Transfer Its Properties and Franchises

The Arkansas-Missouri Power Company submitted an application for approval of a Plan of Reorganization of the Company and the Commission, after a hearing on November 14, 1935, entered an order on January 10, 1936, approving the said Plan of Reorganization upon condition that the accruals for retirement expenses shall be based upon our engineers estimate of the depreciable property of the Company as at May 31, 1935 and subsquent net additions and betterments to such property and that the accruals for electric property shall be at the rate of 3 per cent and the accruals for water property at the rate of 1½% per cent. The said order further authorized the issuance of securities as provided in the said Plan of Reorganization,

subject, however, to the approval of the Commission as to the form of the various instruments to be executed.

The Company filed another application on January 13, 1937, together with a modified Plan of Reorganization, to be substituted for the Plan of Reorganization approved by the Commission in its order of January 10, 1936. The Commission, by a supplemental order entered on January 14, 1937, authorized the said substitution, with a provision that the order issued by the Commission on January 10, 1936, should remain unchanged, except as provided in the said supplemental order.

The Arkansas-Missouri Power Company, an Arkansas corporation, and the Arkansas-Missouri Power Corporation, a Delaware corporation, licensed to operate in Missouri, filed an application with the Commission April 30, 1937 accompanied by the following instruments:

1. Certified copy of order entered by the District Court of the United States in and for the Northern District of Illinois, Eastern Division, confirming the said Modified Plan of Reorganization and hereinbefore referred to.

2. A copy of articles of incorporation of the Corporation.

3. Draft of indenture between the Corporation and Continental Illinois National Bank and Trust Company of Chicago and Carl W. Allendoerfer, as trustees, dated as of January 1, 1937, prepared for delivery pursuant to the said Modified Plan of Reorganization which will secure $2,834,625 First Mortgage 5% Bonds, Series A, dated January 1, 1937, due January 1, 1957.

4. Form of certificate prepared to evidence the preferred stock of the Corporation.

5. Form of certificate prepared to evidence the Common Stock of the Corporation.

6. Form of temporary stock purchase warrant providing for the right to purchase 16,000 shares of Common Stock of the Corporation at a price of $9 per share on or before December 31, 1938, and at a price of $10 per share on or before December 31, 1941, with certain provisions protecting the rights of purchase therein given.

7. Form of cash scrip agreement providing for the issuance of cash scrip in the amount of $200,313.50, which includes the form of cash scrip to be issued.

8. Copy of scrip to be issued to holders of outstanding $20 bonds of the Company, unless presented in multiples so that bonds of the available denominations can be delivered. In this connection one of the $20 bonds of the Company now outstanding will be purchased and cancelled.

9. Copy of scrip to be delivered to parties entitled to receive fractional shares of Preferred Stock under the plan.

10. Copy of scrip to be delivered to parties entitled to receive fractional shares of Common Stock under the plan.

The application states that Arkansas-Missouri Power Corporation has been organized pursuant to said Plan of Reorganization and that the Corporation now has outstanding no stock, securities nor other indebtedness.

The Arkansas-Missouri Power Corporation, pursuant to said Modified Plan of Reorganization, proposes to issue the following securities:

A. $2,834,625 First Mortgage 5% Bonds, Series A, having the terms and rights provided in and being secured by the indenture hereinbefore referred to.

B. Special Bond Coupons payable on or before the first day of January, 1940, without interest, aggregating the sum of $36,692.50.

C. Cash Scrip, payable only from the sources provided in Section 6 of the Cash Scrip Agreement, in the amount of $200,313.50.

D. 18,897.50 shares of 6% Cumulative Preferred Stock, having a par value of $944,875, provided, however, scrip for fractional shares will be issued, the certificates evidencing such Preferred Stock and Scrip to be in the form submitted with said application.

E. 182,605 shares (or such lesser amount as may be requisite) of Common Stock, provided, however, scrip will be issued in lieu of fractional shares, the certificates evidencing such Common Stock and Scrip to be in the form submitted with said application.

F. Common Stock Purchase Warrant for 16,000 shares, in the form submitted with said application.

The First Mortgage 5% Bonds, Series A, dated January 1, 1937 and maturing January 1, 1957, may be redeemed at any time upon the payment of the principal amount thereof and the accrued interest thereon to the date fixed for redemption. A sinking fund in an amount equal to 25 per cent of available net earnings, as defined in the indenture of mortgage, makes provision for the retirement of the Series A bonds.

The procedure to be followed in the consummation of said Modified Plan of Reorganization is set forth in said application of Arkansas-Missouri Power Company and Arkansas-Missouri Power Corporation.

The said application does not present any new matter for consideration by the Commission, except consideration of the forms of documents to be used in connection with the issuance of securities which have been considered

by the Commission. The United States District Court in and for the Northern District of Illinois, Eastern Division, has entered an order approving the said documents and authorizing the issuance of the securities under the Modified Plan of Reorganization. A certified copy of said order will later be filed with the Commission.

The Commission is of the opinion that the amount of stocks, bonds, warrants, special bond coupons and cash scrip proposed to be issued under the said Modified Plan of Reorganization does not exceed the fair value of the property involved and further finds that, in its opinion, the property to be paid for by the issuance of said securities is reasonably required for the purpose of effecting a reorganization of Arkansas-Missouri Power Company.

It is, therefore,

Ordered: 1. That Arkansas-Missouri Power Company be and it is hereby authorized to transfer its properties, rights and franchises to Arkansas-Missouri Power Corporation and that Arkansas-Missouri Power Corporation be and it is hereby authorized to own, operate and maintain such properties, rights and franchises, and further, that the transfer of the power line now under construction in Arkansas may be delayed and transfers or conveyances made from time to time hereafter, with the understanding that no additional consideration will be payable by Arkansas-Missouri Power Corporation on account of such transfers, except reimbursement to Arkansas-Missouri Power Company for any amounts expended and the assumption of any liabilities incurred by Arkansas-Missouri Power Company in connection with the construction or completion of said power line.

Ordered: 2. That the Arkansas-Missouri Power Corporation is hereby authorized to issue and distribute, in accordance with the said Modified Plan of Reorganization, its

First Mortgage 5% Bonds, Series A, dated January 1, 1937 and maturing January 1, 1957, in the aggregate principal amount of Two Million, Eight Hundred Thirty-four Thousand, Six Hundred Twenty-five Dollars ($2,834,625) with Special Bond Coupons in addition to interest coupons thereto attached, aggregating Fifty-six Thousand Six Hundred Ninety-two Dollars, Fifty Cents ($56,692.50), under and pursuant to the terms, conditions and covenants of an indenture of mortgage dated January 1, 1937, from the said Corporation to Continental Illinois National Bank and Trust Company of Chicago, Illinois and Carl W. Allendoerfer of Kansas City, Missouri, as Trustees, the same to be in the form or substantially in the form of the indenture of mortgage submitted to the Commission.

Ordered: 3. That the said First Mortgage 5% Bonds, Series A, shall bear interest at the rate of 5% per annum, payable semi-annually on the first days of January and July in each year until the bonds are redeemed; that the said Special Bond Coupons attached to said bonds shall be payable on or before the first day of January, 1940.

Ordered: 4. That the Arkansas-Missouri Power Corporation is hereby authorized to issue and dispose of 18,897½ shares of its 6% Cumulative Preferred Stock having a par value of Nine Hundred Forty-four Thousand, Eight Hundred Seventy-five Dollars ($944,875), with scrip for fractional shares, pursuant to said Modified Plan of Reorganization.

Ordered: 5. That the Arkansas-Missouri Power Corporation is hereby authorized to issue and dispose of 182,605 shares of Common Stock pursuant to said Modified Plan of Reorganization. Of these shares, 166,605, or such lesser number as may be necessary to make complete distribution under said Modified Plan of Reorganization, shall be distributed among the holders of Arkansas-Missouri Power Company bonds, debentures, unsecured notes, claims and

preferred stock. The remaining 16,000 shares shall be held by the Treasurer of the Arkansas-Missouri Power Corporation to be delivered from time to time on the exercise of a certain Stock Purchase Warrant or Warrants issued in substitution therefor, as hereinafter authorized. Any warrants not delivered pursuant to the exercise of said Stock Purchase Warrant or Stock Purchase Warrants issued in substitution therefor shall not be sold nor delivered unless such sale shall be authorized by the Commission and the Treasurer of the Corporation shall hold any such stock not delivered as aforesaid subject to such conditions. The proceeds from the sale of any such shares of stock delivered on exercise of Stock Purchase Warrants shall be used by the Corporation for one or more of the following purposes, to-wit: (1) the retirement of bonds or other indebtedness which shall have been authorized to be issued by the Commission, or (2) for additions and betterments to the properties of the Corporation.

Ordered: 6. That the Arkansas-Missouri Power Corporation is hereby authorized to issue, as provided in the said Modified Plan of Reorganization, Stock Purchase Warrants giving the right to purchase 16,000 shares of Common Stock of Arkansas-Missouri Power Corporation, on or before December 31, 1938, at a price of Nine Dollars ($9) per share and on or before December 31, 1941, at a price of Ten Dollars ($10) per share. The manner of application of the proceeds of said Warrants is set forth in the next preceding paragraph hereof.

Ordered: 7. That the Arkansas-Missouri Power Corporation is hereby authorized to acquire the outstanding Common Stock of the East Missouri Power Company, consisting of 14,547 shares without par value.

Ordered: 8. That the said securities herein authorized shall be used for the purposes set forth in this case and only for such purposes.

Ordered: 9. That nothing herein contained shall be considered as a finding by the Commission of the value of the properties herein involved for rate making purposes, nor as an acquiescence in the value placed upon said properties by the parties.

Ordered: 10. The Arkansas-Missouri Power Corporation shall keep separate, true and correct accounts showing the receipt and application in detail of the issuance of the securities herein authorized and of the securities and unsecured debt and preferred stock surrendered and of the cash paid under the said Modified Plan of Reorganization. At the end of six months from the date hereof the Corporation shall make a verified report to the Commission showing the results in consummating the reorganization. Accounts and vouchers shall be open to audit and may be audited from time to time by accountants and examiners designated for such purpose by the Commission.

Ordered: 11. That this order shall take effect on this date and the Secretary of the Commission shall forthwith serve a certified copy of this order on all interested parties.

By the Commission,
ROBERT E. HOLLIWAY,
Secretary.

Dated at Jefferson City, Missouri the 30th day of April, 1937.

Hargus, Chr., Anderson, Ferguson, Nortoni, CC, concur.

Boyer C. absent.

(Seal)

State of Missouri
Office of the Public Service Commission

I have compared the preceding copy with the original on file in this office, and I do hereby certify the same to

be a correct transcript therefrom and of the whole thereof.

Witness my hand and seal of the Public Service Commission, at Jefferson City, this 11th day of June, 1956.

MARVIN P. MOORE,
Secretary.

Defendant's Exhibits 1-b, 1-c, 1-d and 1-e, income and excess profits tax returns, respectively for the years 1937, 1938, 1939 and 1940 are omitted from the record. They, however, disclose that the Arkansas Missouri Power Corporation kept its books and made its income tax returns on the accrual basis method of accounting on calendar years.

TRANSCRIPT OF TESTIMONY

Testimony for Plaintiff:

J. E. Flanders, James W. Steffes, Charles R. Newcomb and Franklin Atkinson testified on behalf of the Plaintiff and introduced Plaintiff's Exhibits 1 through 6. All of the testimony of these witnesses as well as the exhibits with the exception of Plaintiff's exhibit 4 (R. 51) are omitted from the record.

Testimony for Defendants:

HOMER WOODALL, on behalf of the defendants, testified as follows:

I live in Little Rock. I am employed as an Internal Revenue Agent. I have been in the Internal Revenue Service more than twenty years. My duties are to examine books, records and income tax returns for the purpose of

arriving at the correct tax liability and pass upon claims filed with the government.

I have examined the books and records of the plaintiff in connection with the reorganization. I have assisted the attorneys for the defendants with respect to the claims involved herein.

Day & Zimmerman, Inc., appraisal engineers, were employed by the Bankruptcy Court to appraise the tangible property of the Arkansas Missouri Power Company, which was then in bankruptcy for reorganization. As of May 31, 1935, the appraisers estimated that the gross replacement value of such property was $4,968,905, that the accrued depreciation with respect thereto was $558,718, and that the net value was $4,410,087. The plaintiff as of May 1, 1937, entered on its opening balance sheet as the gross value of the tangible property (plant) $4,691,343.73, with accrued depreciation $678,912.09, leaving a net value of plant of $4,012,431.64. The plaintiff's net value (entered on its books) was $397,655.35 less than the net value found by Day & Zimmerman.

Some of this difference arose from additions and retirements between the date of the appraisal (May 31, 1935) and the date of the balance sheet (May 1, 1937), the date of reorganization. A majority of the difference was due to the fact that the plaintiff considered certain values in the Day & Zimmerman appraisal to be too high.

The engineering section of the Internal Revenue Service did not approve the property values as entered on plaintiff's balance sheet. Our engineers appraised the tangible assets as of May 1, 1937 at a gross value of $4,559,170.84 and set up a depreciation reserve against that value of $1,088,294.43, leaving a net value of $3,603,049.30, thus reducing the net value of the property $409,382.34.

The witness introduced and explained Defendant's Exhibit 1. It is a statement comparing the basis of proper-

ties per books as of May 1, 1937 with the basis set forth in the letter dated March 5, 1941 written by the Revenue Agent. [The letter is Plaintiff's Exhibit No. 8 (R. 57). Defendant's Exhibit 1 is set forth in full in Finding 18 of the District Court's Memorandum (R. 28)].

The effect of the adjustment made by this letter was to reduce the tax cost basis of the depreciable property acquired by the plaintiff on reorganization $409,382.34. This was accomplished by adding that amount to the Reserve for Depreciation, with the following results: In the event of a sale of the property acquired, the tax cost basis fixed by the letter would be used for the purpose of determining loss or gain. Whenever the Depreciation Reserve equals the tax cost basis, no further depreciation will be allowed on the property as an income tax deduction. This adjustment permitted depreciation to be calculated on a larger base over a shorter period of time than would have been permissible had the figure of $409,382.34 been deducted from property values instead of added to the Reserve for Depreciation.

The property acquired consisted of many depreciable items of varying values as entered upon the books. Had the adjustment been made to the asset side, the values would have been reduced and it would have been necessary to reprice each of these items so that they might be retired at the reduced value.

The Witness introduces and explains Defendant's Exhibit 2 [This exhibit is set out in full in Finding numbered 28 of the District Court's Memorandum (R. 30)]. It is a statement showing the assets and liabilities per their (Company) books compared with the assets and liabilities as we reflected them, the engineering section reflected them by reducing them $409,382.34. The engineering section did not set up the figure in the form I have shown on this Exhibit 2. In the letter of March 5, they only dealt with depreciable

property. I am dealing with all the assets and liabilities. I deducted the $409,382.34 from net plant and credited paid in surplus or common stock. I am making common stock bear the whole reduction. Where a basket of securities are issued and the seller receives less than par for them, we first attack the paid in capital on common stock. We take those securities in their order of payment and the one that's paid in last is reduced first where a basket of securities is exchanged for property.

Based upon that statement, I would say that the bonds were not issued at a discount. The value of the property securing the bonds exceeded their par value. To date, the plaintiff's income has not been affected by the $409,382.34 adjustment. There will come a time when it will affect plaintiff's income.

Ordinary depreciation would not appear in a transaction where bond discount is present. The period when we will stop allowing annual depreciation will be speeded up because we added the $409,382.34 to the Reserve. I would have reduced the gross properties by the $409,382.34 adjustment. When the time arrives, this adjustment will cause the Company to suffer. I define bond discount as follows: "It is when a bond is sold or issued by the borrower • • • and he receives less than par on the exchange or on the sale." I have found it to be true in practically every instance where bonds were sold at a discount, there were mortgages back of them covering property equal to their par value.

Since I testified yesterday in this case, I had occasion to go further into the method the utilities use in handling their depreciation. Their method is different from ordinary business and because of the peculiar circumstances their depreciation is based upon the gross cost of the property and any retirements they make because of obsolesence is taken out of that base and charged to the reserve and I

find after further study that they will never be penalized on account of the depreciation credit we made to the reserve. It would be a physical impossiblity for us to penalize them. The only way we could recover the gross value they have got on their books is when they sell their plant, their profit would be increased by this $409,000 adjustment.

Arkansas-Missouri Power Corporation, Plaintiff, vs. Roy Paschal, et al, former Collectors of Internal Revenue for the District of Arkansas, Defendants.	Consolidated No. 1846

Notice of Appeal

(Filed in the U. S. District Court for the Eastern District of Arkansas on August 1, 1956)

Notice is hereby given that Arkansas-Missouri Power Corporation, the plaintiff in the above styled cause of action, appeals from the final judgment of the United States District Court for the Eastern District of Arkansas, Western Division, entered by said Court on July 6, 1956, to the United States Circuit Court of Appeals for the Eighth Circuit.

ARKANSAS-MISSOURI POWER CORPORATION

/s/ P. A. Lasley

Attorney for Plaintiff.

Docket Entries

Docket No. 1846—Civil

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal and Horace E. Thompson,
former Collectors of Internal Revenue
for the District of Arkansas,
Defendants.

1948	
December 15	Complaint filed. Summons issued and handed Marshal.
1949	
February 15	Answer filed.
1951	
January 23	Plaintiff's Request for Admission of Facts filed.
February 7	Defendant's response to plaintiff's request for admission of facts filed.
April 20	Motion for Leave to file Amended Complaint filed.
April 26	Hearing on Plaintiff's Motion for Leave to file Amended Complaint. After argument of counsel the Court granted motion. Amended Complaint filed. Defendant allowed 30 days to file responsive pleading.
May 24	Answer to Amended Complaint filed.
1952	
September 27	Deposition of James W. Steffes on behalf of Plaintiff filed.

Docket Entries

Docket No. 1847—Civil

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal and Horace E. Thompson,
former Collectors of Internal Revenue
for the District of Arkansas,
Defendants.

1948	
December 15	Complaint filed. Summons issued and handed Marshal.
1949	
February 15	Answer filed.
1951	
January 23	Plaintiff's Request for Admission of Facts filed.
February 7	Defendant's Response to Plaintiff's Request for Admission of Facts filed.
April 20	Motion for Leave to file Amended Complaint filed.
April 26	Hearing on Plaintiff's Motion for Leave to file Amended Complaint. After argument of counsel the Court granted the motion. Amended Complaint filed. Defendant allowed 30 days to file responsive pleading.
May 24	Answer to Amended Complaint filed.
1952	
September 27	Deposition of James W. Steffes on behalf of Plaintiff filed.

Docket Entries

Docket No. 1889—Civil

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal, former Collector of Internal Revenue for the District of Arkansas,
Defendant.

1949	
March 18	Complaint filed. Summons issued and handed Marshal.
July 18	Answer filed.
1951	
January 23	Plaintiff's Request for Admission of Facts filed.
February 7	Defendant's Response to Plaintiff's Request for Admission of Facts filed.
April 20	Motion for Leave to File Amended Complaint filed.
April 26	Hearing on Plaintiff's Motion for Leave to file Amended Complaint. After argument of counsel the Court granted motion. Amended complaint filed. Defendant allowed 30 days to file responsive pleading.
May 24	Answer to amended complaint filed.
1952	
September 27	Deposition of James W. Steffes on behalf of Plaintiff filed.

Docket Entries

Docket No. 2296—Civil

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal, former Collector of Internal Revenue for the District of Arkansas, and W. D. Self, Acting Collector,
Defendants.

1951	
June 21	Complaint filed. Summons issued and handed Marshal.
August 20	Separate motion of Defendant, Roy Paschal, to Dismiss, and Answer filed.
1952	
September 27	Deposition of James W. Steffes on behalf of Plaintiff filed.

Docket Entries

Docket No. Consolidated 1846—Civil

Arkansas-Missouri Power Corporation,
Plaintiff,

vs.

Roy Paschal, Horace E. Thompson, former Collectors of Internal Revenue for District of Arkansas, and W. D. Self, Acting Collector,
Defendants.

1952	
October 10	Order of Consolidation by Judge Delehant filed. Nos. 1846, 1847, 1889 and 2296 to be proceeded further under No. 1846.
1954	
February 4	Pre-trial before Trimble, J. Issues defined. Jury Trial waived.
1955	
October 26	Notice to Clara K. Paschal, Administratrix of Estate of Roy Paschal, Deceased; Horace Thompson; and W. D. Self as to hearing on October 31 on Motion to Revive filed.
November 1	Order by Trimble, J. substituting Mrs. Clara K. Paschal, Admx. of Estate of Roy Paschal, deceased, as party defendant filed.
December 22	Depositions of J. E. Flanders, Chas. R. Newcomb and F. E. Atkinson, witnesses for plaintiff, filed.
1956	
June 18	Deposition of Homer Woodall, witness for defendants, filed.

June 25	Stipulation of Counsel with exhibits attached filed.
June 29	Argument of Counsel before Trimble, J.
July 6	Opinion and Order dismissing complaints of Plaintiff filed.
August 1	Plaintiff's Notice of Appeal together with Bond on Appeal, filed.
August 27	Order by Trimble, J. clarifying memorandum of July 6, 1956 filed.
August 27	Order extending until October 29, 1956, time for filing record and docketing appeal filed.
November 1	Designation of Record filed.

No. 330

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 15,676
CIVIL

ARKANSAS-MISSOURI POWER CORPORATION,
APPELLANT

vs.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, ET AL,
APPELLEES

APPEAL FROM THE
UNITED STATES DISTRICT COURT, WESTERN DIVISION, EASTERN DISTRICT OF ARKANSAS

PETITION FOR REHEARING

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FILED

QUAPAW PRINTING CO., LITTLE ROCK

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 15,676
CIVIL

ARKANSAS-MISSOURI POWER CORPORATION,
APPELLANT

vs.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, ET AL,
APPELLEES

APPEAL FROM THE
UNITED STATES DISTRICT COURT, WESTERN DIVISION, EASTERN DISTRICT OF ARKANSAS

PETITION FOR REHEARING

TO THE HONORABLE JUDGES OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT:

The Arkansas-Missouri Power Corporation, the appellant in the above entitled cause presents this its petition for rehearing in the above cause and in support thereof, respectfully shows:

1. That on May 3, 1957, the Court filed its Opinion in the above cause in favor of the appellees and against the appellant affirming the judgment of the United States District Court for the Western Division of the Eastern District of Arkansas.

2. That on May 3, 1957, judgment in pursuance of the said Opinion was entered.

3. The Court overlooked and failed to give any legal effect to the controlling issues and basic facts found by the Trial Court and accepted by this court, to wit:

(a) That the appellant issued and gave for property having a fair market value of $4,084,587.60 Preferred and Common Stock having respectively a fair market value of $680,313.60 and $994,830, and Bonds having a par value of $2,834,625. [See Findings 25 and 27 (R. 29-30)]. On pages 18-20 of its brief in chief the appellant cited a long list of authorities which demonstrated that the fair market value of the assets actually received by appellant for bonds having a par value of $2,834,625 was only $2,409,444 — $425,181 less than the par of the bonds.

(b) The Court, in holding that the bonds were not issued at a discount, overlooked the aforesaid facts that the amount actually received for the bonds was less than their par and failed to give any weight to a long list of authorities cited on pages 21 and 22 of appellant's brief in chief, and especially the holding of the Circuit Court of Appeals for the Third Circuit in *American Smelting and Refining Company* v. *U. S.*, 130 F. 2d. 883 (1942), wherein it was held that bonds were issued at a discount when issued and exchanged for property having a fair market value less than the par value of the bonds.

(c) The Court, in refusing to follow the American Smelting case and the long list of authorities cited on page 22 of appellant's brief in chief, with the assertion that the cited cases are distinguishable in their facts, overlooked the fact that there is no substantial difference in the facts here and those present in the cases cited.

(d) The Court, on page 9 of its opinion, held that the sale price of bonds on the open market has no bearing on whether they were issued at a discount. If, by this statement, the Court meant that the sale price on the open market was the basis of appellant's claim of discount, it overlooked appellant's contention that its claim of discount was based on the fact that the fair market value of the property received for the bonds was less than their par or maturity value. (See Appellant's Reply Brief, page 7.)

(e) The Court by its Opinion resolved the issues here involved into matters of first impression by holding in effect that discount can never arise on bonds issued in a reorganization under Sections 77A and 77B of the Bankruptcy Act.

(f) The Court overlooked the fact that its Opinion and the conclusion, that the bonds of appellant were not issued at a discount, are in hopeless conflict with the decision of the Court of Appeals of the Third Circuit in the *American Smelting Case*, Supra.

If, by the language of the Opinion, page 9, to the effect that the fair market value of the property of the bankrupt transferred to the appellant exceeded the fact value of its bonds, the Court meant that all of the difference between such value of the property and the aggregate of the fair market value of the stocks and the par value of the bonds should be charged against the stock and not allocated between the stock and bonds, the Court overlooked the rule universally applied in allocating a unit consideration to stocks and bonds in the case of *Hummel-Ross Fibre Corporation* v. *Commissioner*, 79 F. 2d. 474 (Fourth Circuit, 1935) and followed by a long list of authorities shown on pages 18-20 of Appellant's brief in chief; and further, the Court overlooked the fact that such a conclusion is in hopeless conflict with these authorities.

4. With due deference, the appellant insists that since the Court decided matters of first impression and because of the importance of the legal questions involved, this petition for rehearing should be considered by the Court *en banc* and upon such consideration a rehearing before the Court *en banc* be ordered. The appellant respectfully requests that such action be followed.

WHEREFORE, appellant prays that a rehearing be granted, that the judgment of the Court heretofore entered on May 3, 1957 be vacated, that the judgment of the District Court be reversed, and that the opinion of this Court be

modified to agree with the provisions of law, the controlling facts, and authorities set out in the foregoing petition for rehearing.

Respectfully submitted,

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CERTIFICATE

I, P. A. Lasley, of counsel for the appellant in the above styled cause, do hereby certify that upon careful examination of the opinion of the Court in this case, I verily believe that the facts stated and quoted in the attached petition for rehearing have been overlooked by the Court and that these facts are material; and I also verily believe that the Court has overlooked and failed to apply decisions and authorities set out in such petition which are controlling and which, if followed, would require a different judgment from that rendered and that the Court has erroneously misapplied controlling authorities and has drawn incorrect conclusions contrary to the positive facts.

Dated May 20, 1957.

P. A. LASLEY

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FILED
JUL 31 1957
JOHN T. FEY, Clerk

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 330

ARKANSAS-MISSOURI POWER CORPORATION, *Petitioner*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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RECORD PUBLISHERS, INC., LITTLE ROCK, ARK.

INDEX

Opinions Below 2

Jurisdiction 2

Question Presented 2

Statutes and Regulations Involved 3

Statement 4

Reasons for Granting the Writ 10

Conclusion 20

Appendices:

A.—Opinion of the United States Court of Appeals for the Eighth Circuit 1a

B.—Judgment of the United States Court of Appeals for the Eighth Circuit 10a

C.—Order of the United States Court of Appeals for the Eighth Circuit Denying Petition for Rehearing 11a

D.—Statutes and Regulations Involved 12a, 13a

CITATIONS

CASES:

American Smelting & Refining Co. v. United States, 130 F. 2d 883 ..... 8, 12, 13, 15, 16

Helvering v. Union P. R. Co., 293 U. S. 282 ..... 11, 13, 14

Hummel-Ross Fibre Corp. v. Commissioner, 79 F. 2d 474 8

Industrial Development Corp. v. United States, Sec. 72-911 PH Fed. 1956 12

Kansas City Southern R. Co. v. Commissioner, 22 BTA 949 16

Montana Power Company v. United States, 121 F. Supp. 577; 232 F. 2d 541 ..... 12, 13, 18

Natural Gas Pipe Line Co. v. Commissioner, 45 BTA 939 ..... 9, 12

New York C. & St. L. R. Co. v. Commissioner, 23 BTA 177, aff'd. 64 F. 2d 152 16

Pierce Oil Corporation v. Commissioner, 32 BTA 403 9

Sacramento Medico Dental Bldg. Co. v. Commissioner, 47 BTA 315 18

Southern Fertilizer Co. v. Edwards, Admr., 55-1 USTC Sec. 49-133 ..... 8, 12

Southern Ry. Co. v. Commissioner, 27 BTA 673 16

STATUTES:

Revenue Act of 1936, C. 690, 49 Stat. 1648:

Section 112(b) (4) 12a

Section 112(g) (1) (c) 12a

Section 113(a) (7) 12a-13a

MISCELLANEOUS:

Treasury Regulations 103, Section 19.22(a)-18 ..... 13-a

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No.....

ARKANSAS-MISSOURI POWER CORPORATION, *Petitioner*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Arkansas-Missouri Power Corporation, your Petitioner, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above entitled case on May 3, 1957.

Citations to Opinions Below

The opinion of the United States District Court for the Eastern District of Arkansas is reported at 144 Federal Supp. 272 (R. 23). The Opinion of the Court of Appeals, (Appendix A hereto, *infra*, pp. 1a-9a) is reported at 243 Fed. 2d 584.

Jurisdiction

The judgment of the Circuit Court of Appeals is dated and was entered on May 3, 1957 (Appendix B hereto, *infra*, p. 10a). On June 3, 1957, the Court of Appeals entered an order denying Petition for Rehearing (Appendix C hereto, *infra*, p. 11a).

The jurisdiction of this Court is invoked under the provisions of Section 1245 (1) Title 28 United States Code.

Question Presented

Where a corporate tax payer, keeping its accounts on the accrual basis, issues its First Mortgage Bonds, Common Stock and Preferred Stock, and with cash and cash scrip exchanges them as a "package" in the reorganization transaction under §§ 77A and 77B of the Bankruptcy Act for property having a fair market value as of the date of the issuance and exchange of said bonds, stock, etc., of $425,181 less than the aggregate market value of the stocks, etc., as of the date of their issuance, plus the par or maturity value of the bonds, does the amount of $425,181 constitute discount on the issuance of the bonds amortizable and deductible for income tax purposes by the tax payer over the life of the bonds?

Statutes and Regulations Involved

The statutes and regulations involved in this case are Section 112(b) (4), Section 112(g) (1)C and Section 113 (a) (7) of the Revenue Code of 1936 (C 690, 49 Stat. 1648), and Section 19.22 (a)-18 of Treasury Regulation 103. The statutes and regulations are set out in Appendix D, *infra*, pp. 12a-13a.

Statement

In a judgment dated May 3, 1957, the United States Courts of Appeals for the Eighth Circuit affirmed a judgment for the respondents entered on July 6, 1956 by the United States District Court for the Eastern District of Arkansas dismissing complaints in a consolidated civil action arising under the Internal Revenue Code of 1939 brought by the Arkansas-Missouri Power Corporation, petitioner herein, against ex-collectors and an acting collector of Internal Revenue for the District of Arkansas seeking the recovery of income and excess profits taxes alleged to have been erroneously and illegally assessed and collected from the petitioner by the said several respondents while in office and acting in their respective official capacities for the taxable years 1939, 1940, 1941, and 1942 (R. 33).

The jurisdiction of the District Court was invoked under § 1340, Title 28, United States Code, and that of the Court of Appeals under § 1291, Title 28, United States Code.

In the District Court, Roy G. Paschal was named defendant and upon his death, the cause of action was timely revived in the name of Clara K. Paschal, Administratrix of the Estate of Roy G. Paschal, deceased (R. 88).

The Opinion of the Court of Appeals and its judgment based thereon dealt with two questions involving substantive income tax issues — first, did the petitioner issue its bonds at a discount? And, second, if the bonds were issued at a discount, is the net amount of such discount amortizable and

deductible for income tax purposes over the life of the bonds?

The Court of Appeals held that if the bonds were issued at a discount, the net amount thereof was amortizable and deductible over the life of the bonds (Appendix A. *infra*, p. 8a). That Court however, held that the bonds were not issued at a discount.

This Petition for Writ of Certiorari is directed to the question involving whether petitioner issued its bonds at a discount.

The following facts are based on findings by the District Court or non-controverted evidence appearing in the record, and were approved by the Court of Appeals.

The petitioner, Arkansas-Missouri Power Corporation, a Delaware corporation, having its principal office and place of business in Blytheville, Arkansas, as of May 1, 1937, pursuant to an order of the United States District Court, Northern District of Illinois, approving a Plan of Reorganization of the Arkansas-Missouri Power Company (hereinafter called the debtor), then in bankruptcy for reorganization under §§ 77A and 77B of the National Bankruptcy Act (C 424, 48 Stat. 912) acquired all of the assets of the debtor, free of liens, except taxes and certain obligations assumed, which assets on the date of acquisition by the petitioner had a fair market value of $4,084,587.60 (F. 21, R. 29[1]).

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[1] F refers to the number of the findings by the District Court and R to the page of the record printed for the use of the Court of Appeals filed herewith.

For these assets as of May 1, 1937, the petitioner paid $83,149.44 cash, issued cash scrip, first mortgage twenty years 5% bonds of the par or maturity value of $2,834,625, 165,805 shares of Common Stock of the par value of $1.00 per share, assigned a book value of $714,460.94, 18.897 1-2 shares of 6% Cumulative Preferred Stock of the par value of $50 per share, aggregating $944,875 (F. 26 and 28, R. 30).

The cash and cash scrip and the bonds and stocks were delivered as a "package" payment for the debtor's assets acquired by the petitioner.

The fair market value on the date aforesaid of the first mortgage bonds was $2,409,444, of the Preferred Stock was $680,313.60 and of the Common Stock was $994,830, making a total aggregate fair market value of the securities of $4,084,587.60 (F. 27, R. 30), exactly the same amount as the fair market value of the asset acquired[2].

On May 1, 1937, the debtor had outstanding the following securities:

First Mortgage Bonds, as follows: $32,000 5%; $3,303,500 6%; $444,020 7%; interest on bonds unpaid from January 1, 1935;

6 1-2% Debentures in the amount of $787,600, interest unpaid from November 1, 1934;

Unsecured Notes $386,500; 12,859 shares 7% Cumulative Preferred Stock of the par value

[2] The intangible properties acquired are listed on Page 60 of the Record and aggregate $1,280,944.99. From this figure is deducted $799,406.99, representing liabilities assumed (R 61). Included in the liabilities assumed was the amount of cash and cash scrip which the petitioner was to pay and issue as a part of the consideration for the property acquired.

of $100 per share; 160,000 shares of Common Stock, par value $1 per share (p. 2, Plan, R. 51).

The petitioner in the years hereinafter set forth called for redemption and retired by payment in cash the par amount of bonds, as follows:

1937 — $25,000; 1938 — $40,660; 1939 — $62,215; 1940 — $2,706,765 (R. 43-44).

The Internal Revenue Service (R. 59), the District Court (F. 23, R. 29) and the Court of Appeals (Appendix A. *infra*, p. 4a) all held that the reorganization as carried out and in connection with which the petitioner acquired the aforesaid assets and issued the aforesaid securities was a taxable reorganization under the income tax laws of the United States.

The petitioner, on its books, valued the assets acquired by it at $4,493,969.94 and treated this amount as the cost thereof, also shown by its books were the sums of $2,834,635 First Mortgage Bonds, Preferred Stock $944,875, Common Stock $714,460.94, or a total of $4,493,969.94 (F. 28, R. 30).

The Internal Revenue Service did not accept as petitioner's tax cost base the amount of $4,493,969.94, and, since the reorganization was taxable, the Service reduced the tax cost base $409,482.34, or to $4,084,587.60 (R. 60), which amount exactly equalled the aggregate fair market value of the assets acquired and also equalled the fair market value of the securities issued and delivered in payment therefor (F. 28, R. 30).

The basic or controlling facts may be summarized as follows:

The fair market value of the lump sum consideration (the debtor's assets) received by petitioner in exchange for its bonds and stocks on May 1, 1937, the effective date of reorganization, was $4,084,587.60; and on said date the fair market values of the bonds, common and preferred stocks were, respectively, $2,409,444, $994,830, $630,313.60.

The ultimate fact to be determined from the foregoing basic facts is: What amount of the lump sum consideration received by the petitioner for all of its securities was received for the bonds?

It has long been the rule universally followed by the Court of Appeals, the District Courts and the Board of Tax Appeals, when confronted with the problem of determining what amount of a lump sum consideration was received for bonds or other debt obligations and stocks, to allocate the lump sum consideration to the several classes of securities on the basis of their respective fair market values. The following cases establish and apply the rule. *American Smelting and Refining Company* v. *United States* (Third Circuit) 130 Fed. 2d 883, involving the issuance of bonds and the payment of cash for Preferred Stock; *Hummel-Ross Fibre Corporation* v. *Commissioner* (Fourth Circuit), 79 Fed. 2d 174, involving the issuance of bonds and stock for cash; *Southern Fertilizer Company* v. *Edwards, Admr.* (U. S. District Court for the Middle District of Georgia), 55-1 USTC § 49-133, involving the payment of cash and the issuance and delivery of new Preferred Stock, scrip and de-

benture bonds in exchange for a lump sum consideration consisting of Preferred Stock; *Natural Gas Pipeline Company* v. *Commissioner*, 45 BTA 939, involving the issuance of bonds and stock in exchange for notes; *Pierce Oil Corporation* v. *Commissioner*, 32 BTA 403, involving the exchange of debentures and common stock for cash.

The application of the allocation formula to the basic facts in the instant case establish as an ultimate fact that the petitioner received for $2,834,625 par or maturity value bonds only $2,409,444 in property — $425,181 less than the par value of the bonds.

The petitioner contends that the $425,181, the difference between the par value of its bonds and the market value of the property received for them, constitutes discount on the issuance of the bonds; and that it is entitled to amortize and deduct such differential as bond discount pro rata over the life of the bonds pursuant to Treasury Regulation 103, Section 19.22(a)-18(3) (a), (Appendix D, *infra*, p. 13a); and that such deduction entitled the petitioner to a reduction of its income and excess profits taxes for the years 1939, 1940, 1941 and 1942 in the respective amounts, to wit: $5,542.73, $51,607.36, $91,244.26, $32,367.87, or a total for all of the years of $180,762.22 (F. 1, R. 23).

The District Court, ignoring in effect its findings of basic facts and the ultimate fact determinable therefrom, held that the bonds were not issued at a discount (R. 38). It apparently took the view that since the bonds were issued in a reorganization transaction under Sections 77A and 77B of the

Bankruptcy Act, they, as a matter of law, could not have been issued at a discount, notwithstanding the fact that the consideration received for them was less than their par or maturity value.

The petitioner appealed the decision of the District Court to the United States Court of Appeals for the Eighth Circuit. On May 3, 1957, the Court of Appeals affirmed the decision of the District Court apparently holding that since the bonds were issued in a reorganization transaction under the said sections of the Bankruptcy Act, they were not issued at a discount, and brushed aside as not applicable the authorities holding that bonds were issued at a discount where the amount received for them was less than their par. The Court of Appeals, however, held that if the bonds had been issued at a discount, the net amount thereof was deductible and should be pro rated or amortized over the life of the bonds (Appendix A, *infra* p. 8a).

Reasons for Granting the Writ

I. The decision below states principles of law directly in conflict with prior decisions of this Court and other Federal Courts.

II. The decision below raises an important question of Federal law which has not been, but should be, settled by the Court.

1. The opinion of the Court below to the effect that petitioner's bonds were not issued at a discount is in direct conflict with a number of decisions of this and other federal courts.

There is no specific statutory allowance in the Internal Revenue Code of 1939 governing bond discount or its deduction. The bond discount deduction as it applies to the years involved is authorized by regulation issued by the Secretary of Treasury, as follows:

> Regulation 103, Section 19.22(a)-18 "Sale and Purchase by Corporation of its Bonds * * * (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be pro rated or amortized over the life of the bonds * * *."

The above discount regulation has never laid down a rule for measurement of the amount of the discount. The principle inherent in the regulation is that the necessary balance of the tax structure requires an appropriate recognition as a deduction (or income as the base may be) of any difference between the assets received and the principal amount of debt issued therefor. The regulation has been so construed by this Court in *Helvering* v. *Union P. R. Co.*, 293 U.S. 282, by the Statement (page 287):

> "We think that the revenue acts, as they have been interpreted by this Court and the treasury regulations upon this and related subjects, require that this difference between receipts and disbursements of the tax payer should, in some form, enter into the computation of his taxable income."

The "receipts" in the above statement are, of course, the assets received and the "disbursements" are the principal amount of the debt issued.

Following the decision of this Court in the Union Pacific case, the Court of Appeals of the Third Circuit in the American Smelting Case, *Supra*, held that the difference between the market value of that which was received (in that case Preferred Stock) and the par value of the bonds exchanged for such stock was discount.

The District Courts and Board of Tax Appeals have applied the same principle in numerous cases. *Natural Gas Pipeline Company* v. *Commissioner, Supra; Southern Fertilizer Company* v. *Edwards, Admr., Supra; Industrial Development Corporation* v. *U. S.*, Sec. 72-911, PH Fed. 1956 (District Court, Northern District of Illinois).

The question of what constituted discount was before the District Court of New Jersey in *Montana Power Company* v. *U. S.*, 121 Fed. Supp. 577. In that case the tax payer exchanged debentures for utility property, the fair market value of which was not established. It asserted its claim for discount. The District Court denied recovery on the basis that the tax payer had failed to establish the market value of what was received for the debentures. In the course of its opinion, at page 579, the Court said:

> "We, of course, take it as settled law the principles laid down in both Union Pacific and American Smelting * * * that the amount of the discount is the difference between the par value of the debentures and the fair market value of that which the issuer of the debentures received in return therefor, whether this be cash or property."

The Court of Appeals for the Third Circuit in *Montana Power Company* v. *U. S.* 232, Fed. 2d 511, in a majority opinion, reaffirmed its holding in the *American Smelting Company* case, *Supra*, and held that the difference in the market value of that which is received for an original issue of debt obligations and their par value constituted discount.

The holding of this Court in the *Union Pacific* case, *Supra*, and the holdings of other Federal courts, especially of the Court of Appeals for the Third Circuit in the *American Smelting* case, *Supra*, very definitely established the principle that the difference between what is received for an original issue of bonds and their par value constitutes discount. The facts in the case at bar establish that difference with respect to the bonds here involved. The application of the principles of these authorities to the facts in the case at bar conclusively establish that petitioner issued its bonds at a discount.

Apparently, the Court of Appeals pointed out and relied upon two circumstances which distinguished the facts involved in the cited cases from those involved in the instant case. First, the Court said that the bonds in the instant case "were issued as provided by a Plan of Reorganization under Section 77B of the Bankruptcy Act (30 Stat. 554, as amended) and must provide participation for claims and interest strictly in keeping with their priority." Citing cases to the effect of the quoted language (Appendix A, *infra*, p. 8a).

With due deference, the statement is confusing. Did the Court below mean to say that discount on

the bonds is determined and measured not by the difference in the value received for them and their par value, but by what is due to the holders of the old bonds? If such meaning is attributable to the language of the Court below, it certainly sets up a new and novel principle for determining discount, which pinciple is contrary to the concept of discount expressed by this court in the *Union Pacific* case, *Supra,* and other cases cited above.

The amount due the holders of the old bonds could not possibly in any wise have any place in determining what the petitioner received for its bonds or the difference in such receipts and their par value. To illustrate — suppose the petitioner, instead of exchanging stocks and bonds for the assets acquired, had sold its securities for cash at their respective market values ($4,084,587.60 total) and had paid over that amount of cash to the old company in payment for the assets. Would the manner, the extent and the priorities of the distribution of the cash to the creditors of the old Company have any effect on whether petitioner sold its bonds at a discount? The answer to the question is obvious. It would not have.

Therefore, unless there is something in the Bankruptcy Act or the Internal Revenue Code of 1936 that would require the conclusion that bonds could not be issued at a discount when issued in a transaction in a reorganization under the Bankruptcy Act, the bonds in the instant case were issued at a discount.

There is no language in the Bankruptcy Act or the Revenue Code of 1936 or Treasury Regula-

tions issued thereunder upon which to base such a conclusion and the Court of Appeals failed to point to any provisions of either statute that would coerce such a conclusion.

As to reorganization, the Revenue Code of 1936 contains a series of provisions. The principal objective accomplished by these provisions was to classify reorganizations into taxable and non-taxable categories. The provisions referred to are set forth in Sections 112 and 113 of the Revenue Code of 1936, Chapter 690, 39 Stat. 1648. The pertinent parts of these sections are set forth in Appendix D, *infra*, pp. 12a-13a).

The provisions make no distinction between voluntary reorganizations and those growing out of bankruptcy proceedings. The application of these sections to the facts in the instant case resulted in classifying the reorganization here involved as taxable.

The conflict between the holding of the Court of Appeals in the instant case, to the effect that petitioner's bonds were not issued at a discount, and the holding of the Court of Appeals in the *American Smelting* case, *Supra*, and of the several district courts and the Board of Tax Appeals cannot be erased in the manner attempted by the Court of Appeals. The conflict remains, notwithstanding the statement by the Court below:

> "Suffice it to say that the cited cases are distinguishable upon their facts." (Appendix A, *infra*, p. 9a.)

Another statement contained in the opinion of the Court below that may have formed a basis for the distinction which it attempted to make between the facts of the cited cases and those in the instant case is:

> "We are of the opinion that selling the bonds on the open market for 85 cents on the dollar has no bearing on whether the bonds were issued and paid for at par under the record of this case. Nor do the facts in that connection support taxpayer's claim of a deductible discount" (Appendix A, *infra*, pp. 8a-9a).

This reference indicates the confusion of the Court below as to the basis of petitioner's claim of discount. Its claim was based not on the market value of the bonds, but upon the fact that the fair market value of that which was received for them was less than their maturity value. The only use made of the market value of the bonds was in the allocation of the lump sum consideration received for the stocks and bonds to the several classes of securities. Furthermore, the market value of the bonds is a check against, but does not fix, the value of what was received for them. *American Smelting & Refining Co.* v. *U. S.*, *Supra*, page 886.

It has long been the rule that the market value of the debt obligations issued for property is not sufficient to establish that the obligations were issued at a discount. See *Kansas City Southern Ry. Co.* v. *Commissioner*, 22 BTA 949; *Southern R. Co.* v. *Commissioner*, 27 BTA 673; *New York C & St. L. R. Co.* v. *Commissioner*, 23 BTA 177, aff'd. 64 Fed. 2d 152.

Before an apparent conflict between two decisions can be erased or explained away, there must be present a resonable basis as well as a lawful basis for distinguishing them. The conflict between the decisions of the Court of Appeals in the instant case and the cases cited and discussed is real and remains, notwithstanding the attempt of the Court below to justify or explain such conflict.

2. The decision below raises two important questions of federal income and excess profit tax law which have not been, but should be, settled by this Court. The questions are:

(a) Does recognizable discount under Treasury Regulation 103, Sec. 19.22(a)-18 (Appendix D, *infra*, p. 13a) arise out of a transaction where on an original issue of debt obligations are exchanged for property, other than cash, having a fair market value less than the maturity value of the obligations?

(b) Assuming an affirmative answer to the question posed in (a) above, would recognizable discount arise in a transaction in reorganization under Sections 77A and 77B of the Bankruptcy Act, if the facts and results were the same as those stated in (a) above?

Both questions are novel and of first impression in this Court. In fact, the Court below is the first to be confronted with the second question.

The refusal of the Court below to follow the authorities which, if applied to the facts in the instant case, would give rise to discount not only creates a conflict between decisions of two courts of

appeals and is contrary to the decision of this Court, but casts considerable doubt on whether discount can ever arise where debt obligations are exchanged for property.

Moreover, in the case at bar, the Internal Revenue Service established a new tax cost base for the assets acquired by the Petitioner. This base was imposed by the Revenue Act. An inequitable result may be reached and an integrated tax structure upset if the decision of the Court is permitted to stand. *See Sacramento Medico Dental Bldg. Co.* v. *Commissioner* 47 BTA 315.

The basis for issuance of the Writ herein asked for may be summarized, as follows:

(1) The questions presented (*Supra*, p. 17) are before this Court for the first time;

(2) They involve an important area of income tax jurisprudence not covered by statute, but governed wholly by administrative regulation and, more importantly, judicial interpretation;

(3) There is no unanimity among courts and judges as to whether discount may arise on the issuance and exchange of bonds for property other than cash (see Concurring Opinion by Judges Kaldner and Staley in *Montana Power Company* v. *U. S.* 232 F. 2d 511, 515, and the Opinion of the District court in the instant case, (R 31, 35);

(4) The decision below injects into the application of the Treasury Regulation a new and novel concept of discount on the issue of bonds, *i. e.*, discount is not measured by the difference between the market value of the assets the issuer receives

for his bonds and the par value thereof, but by the difference in the amount and priority of a creditor's claim against said assets and the par value of the bonds issued therefor;

(5) The decision below creates more confusion and broadens the area of conflict involving basic principles in the application of the tax law.

The foregoing facts are considerations calling for a clarification essential to a proper and uniform application of the income tax law.

CONCLUSION

The decision of the Court below is in hopeless conflict with the decisions of this and other courts. Furthermore, important questions have been raised by said decision which have not been, but should be, settled by this Court. The Petition for the Writ of Certiorari should, therefore, be granted.

P. A. LASLEY

T. S. LOVETT, JR.

Counsel for Petitioner

APPENDIX A

Opinion of the Court

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 15,676

ARKANSAS-MISSOURI POWER COMPANY, *Appellant*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, *Appellees.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF ARKANSAS

(Filed May 3, 1957)

Before GARDNER, *Chief Judge*, JOHNSEN, *Circuit Judge* and DONOVAN, *District Judge.*

By DONOVAN, *District Judge.*

This appeal is from a judgment of dismissal in four cases consolidated for trial. The appellant will be referred to as the taxpayer, and the appellees will be referred to as the Collector. The learned trial court (following joinder of issue and a pretrial conference) decided the case adversely to the taxpayer.

(1) The taxpayer's only challenge to the court's findings of fact is directed at findings 13 and 29. With respect to finding 29, counsel for the Collector concedes that the plan therein referred to provided for the cancellation of the mortgage. The taxpayer's criticism of finding 29 is directed at the inclusion of the word "entirety" therein. We have in mind that the finding must conform to the facts and evidence as reflected by the record. Commencing our review from this point, it may be said that the present appeal has to do with facts that govern our interpretation of that part of Treasury Regulations 103 applicable in the tax years here involved, which provide:

"Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939:

"Sec. 19.22(a)–18. *Sale and purchase by corporation of its bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If the corporation purchases any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (c) If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

* * * *

"(3) (a) If bonds are issued by a corporation at a discount the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable

year. (c) If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted the excess of the issuing price, plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted), over the purchase price is gain or income for the taxable year. * * *"

The facts of this case are necessarily of a technical nature. Many of them are undisputed. They will be stated as simply as possible for the sake of clarity. On or about February 23, 1935, the United States District Court for the Northern District of Illinois, Eastern Division, approved a petition filed February 21, 1931 of the Arkansas-Missouri Power Company, an Arkansas corporation (predecessor of taxpayer), for reorganization pursuant to Section 77B, Chapter VIII, of the Federal Bankruptcy Act, 11 U.S.C.A. § 207. The properties of the Arkansas-Missouri Power Company were located in 17 counties of Southeast Missouri and Northeast Arkansas and consisted generally of electric generating plants, transmission lines, local distribution systems, ice manufacturing plants, a water system, cash, and accounts receivable.

While the affairs of the old company were in the hands of the District Court and pursuant to the authority and by direction of that court and by consent of the interested parties, Day & Zimmerman, Inc., a nationally known and reputable firm of appraisal engineers, was employed and directed to inventory the property of the predecessor, Arkansas-Missouri Power Company, and make an appraisal report in respect to all the properties of that Company.

Thereafter, Day & Zimmerman, Inc., carried out the appraisal and set forth the results thereof in a report, dated August 26, 1935, entitled "Report No. 3092, on Arkansas-Missouri Power Company, Blytheville, Arkansas," which was filed below as Plaintiff's Exhibit 9. This report was the basis of the plan of reorganization of the Arkansas-Missouri Power Company and was entitled "Modified Plan

of Reorganization of the Arkansas-Missouri Power Company."

Pursuant to the Modified Plan of Reorganization the taxpayer was organized for the purpose of reorganization of the Arkansas-Missouri Power Company and took title to the latter company's property as of May 1, 1937, under the Modified Plan of Reorganization and with the approval of the Bankruptcy Court. Consistent therewith the taxpayer caused to be issued as of May 1, 1937, $2,834,640 of first mortgage 5 per cent bonds due January 1, 1957; $944,880 of 6 per cent cumulative preferred stock of a par value of $50 per share; and 165,805 shares of common stock of a par value of $1 per share in exchange for the properties of the Arkansas-Missouri Power Company and the surrender of the bonds held by the prior mortgagor, whereupon these securities were distributed as shown in the Modified Plan of Reorganization.

As a result of the appraisal by the engineers the property values of the old company were reduced when brought to the books of the taxpayer and, in turn, the taxpayer's net values were reduced by the Internal Revenue Service.

There was some objection to the original plan of reorganization by the Public Utility and Service Commissions of Missouri and Arkansas, and a modified plan of reorganization was agreed to by the interested parties to conform to the wish of the state Commissions. It was a taxable reorganization.

The reorganization was carried out pursuant to the terms and conditions of the Modified Plan of Reorganization agreed to by the interested parties, the Federal District Court before whom the proceeding was pending, and approved by the Public Utilities Commissions of the states in which the company operated.

At the time of reorganization on May 1, 1937, the taxpayer entered upon its books net plant and other assets aggregating $4,493,969.94 as follows: Depreciable property, net after accrued depreciation—$3,880,258.75; Land and non-depreciable property—$132,172.89; Cash and other asset accounts, less liabilities assumed—$115,955.96. Common

Stock of East Missouri Power Company, net—$350,000; Salvage Materials—$15,583.24.

The fair market value of the property listed in the above paragraph as of May 1, 1937, the date of reorganization, did not exceed $4,084,587.60 or $409,382.34 less than the same property was entered on the books of the taxpayer. All of the $409,382.34 is applicable to depreciable property, reducing the figure of $3,880,258.75 to $3,470,876.61.

For the property described above the taxpayer, as heretofore stated, issued and delivered as of May 1, 1937, for distribution as per the Modified Plan of Reorganization, bonds of the aggregate par value of $2,834,625; 18,897½ shares of 6 per cent cumulative preferred stock of the par value of $50 per share, aggregating $944,875; 165,805 shares of common stock of the par value of $165,805; and paid the cash and delivered the scrip, all as provided by the Modified Plan.

The taxpayer also entered upon its books as of the date of the reorganization capital surplus of $548,664.94. It is established that the fair market value on May 1, 1937, of the securities issued as aforesaid was as follows: $2,834,625 par value first mortgage 5 per cent bonds, at 85 per cent of par, aggregating $2,409,444 or $425,181 less than par; 18,897½ shares of 6 per cent cumulative preferred stock, $36 per share, aggregating $680,313.60; 165,805 shares of common stock, $6 per share, aggregating $994,-

830, making a total aggregate fair market value of the securities of $4,084,587.60.

	Per Books	Adj.	As Amended
Depreciable Property	$3,880,258.75		$3,470,876.41
		—409,382.34	
Nondepreciable Prop.	132,172.89		132,172.89
Property Salvage	15,583.24		15,583.24
Stock E. Mo. Power Co.	350,000.00		350,000.00
Cash	612,590.96		612,590.96
Other Assets	302,770.79		302,770.79
	$5,293,376.63		$4,883,994.29
Liabilities Assumed	799,406.69		799,406.69
Net Worth	4,493,969.94		4,084,587.60
Securities Issued			
First Mortgage Bonds	2,834,625.00		2,834,625.00
Preferred Stock at Par	944,875.00		944,875.00
Common Stock at Par	714,460.94		
		—409,382.34	305,087.60
	$4,493,969.94		$4,084,587.60

Subsequent to the redemption of the bonds in 1940 the entire capital stock of East Missouri Power Company, which cost its predecessor, Arkansas-Missouri Power Company, $563,675, was sold on June 7, 1945, at a price of $600,000, the value of which had been shown on the statement of assets received as of May 1, 1937, in exchange for securities in reorganization at $350,000.

At the date of the redemption of the bonds in 1940 there had been no other sales of the properties given to secure the mortgage indenture of January 1, 1937, but the balance sheets of the taxpayer issued subsequent to May 1, 1937, indicated additions by way of purchase and increase in value of all the assets to and including the redemption of the bonds.

The trial court followed its thirty-one findings of fact with a helpful explanatory memorandum. We quote in part therefrom as follows:

> "The foregoing statement comprises various findings of fact proposed by counsel for both parties and will be considered the Court's Findings of Fact, the

controlling elements of which are these: First, the total fair market value of the assets received by the plaintiff on May 1, 1937, established by competent evidence was $4,084,587.60 and the total fair market of the bonds and stocks given in exchange for the assets likewise established was, on May 1, 1937, $4,084,587.60, the fair market value of the preferred stock at $36 a share being $630,313.60, the fair market value of the common stock at $6 a share being $994,830, and the fair market value of the bond issue at 85c on the dollar being $2,409,440.

"From this it is seen that the aggregate fair market value of the common and preferred stock and the par value of the bonds exceeds the fair market value of the assets to the extent of more than $400,000. However, by no method of calculation can the value of the assets be found to be less than the par value of the bonds.

* * * *

"The plaintiff must stand or fall upon its position that its bond issue of $2,834,640 was exchanged at a discount because the aggregate par value of the bonds and the fair market value of the stock issued and delivered for the assets received exceeded the fair market value of the assets to such an extent as to amount to a 15 per cent discount of the bonds. If the stock issued had represented obligations of the corporation as did the bonds, a basis to support this position of the plaintiff would be found: But that was not the situation at all. Stocks such as these constitute what in trade-parlance are known as 'equities.' They may be of great value, of small value, or of no value at all. They had no maturities, and were not direct charges against the assets of the company. True, it was shown, in fact, it was admitted that the stock had a market value but that did not affect the liability of the plaintiff company. The liability of the company for the payment of money was limited to the par value of the bonds issued and it received property

having a value in excess of the amount of the bonds issued.

* * * *

The Arkansas-Missouri Power Corporation was not in the business of buying and selling stocks and bonds and was not directly concerned with the market value of its own securities. Its objectives were to obtain title to the assets of the public utility and to have the privilege of carrying on the business of the utility. It gained both of these objectives by complying with the order of the Federal Court and the requirements of the Public Service Commissions of the States of Missouri and Arkansas.

"I cannot possibly find in this transaction any basis for the position that there was a sale or issue of bonds at a discount and I must hold accordingly."

(2) The sole question raised by this appeal is whether or not the bonds were issued at a discount by the taxpayer pursuant to the above-quoted regulation.

It is not seriously disputed that the bonds in question were issued as provided by a plan of reorganization under Section 77B of the Bankruptcy Act, 30 Stat. 544, chapter 541, as amended, and must provide participation for claims and interests strictly in keeping with their priorities. Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110; Consolidated Products Co. v. Du Bois, 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982.

If the bonds were issued at a discount, the net amount thereof is deductible and should be prorated or amortized over the life of the bonds. Helvering v. Union Pacific Ry. Co. 293 U. S. 282, 55 S.Ct. 165, 79 L.Ed. 363. That the fair market value at the date of reorganization of the bankrupt's property which was transferred to the taxpayer exceeded the face value of the new bonds to be issued was a discretionary matter for the court to determine. Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R. Co., 318 U.S. 523, 63 S.Ct. 727, 87 L.Ed. 959. We are of the opinion that selling the bonds on the open

market for 85 cents on the dollar has no bearing on whether the bonds were issued and paid for at par under the record of this case, nor do the facts in that connection support the taxpayer's claim of a deductible discount.

We have been cited to no case comparable to the facts of this case, and we have found none.

(3) The finding and assessment of the tax in question by the Collector is presumptively correct. Welch v. Helvering, 290 U.S. 111, 54 S.Ct. 8, 78 L.Ed. 212. We have not overlooked the points and authorities cited by able counsel for the taxpayer in its attempt to carry the burden of proof required to be met in this type of case. Suffice it to say that the cited cases are distinguishable on their facts.

(4) Regardless of the claim that the reasoning of the trial court may be wrong in part, we conclude that the result arrived at by the court was right and the judgment entitled to be affirmed on appeal. Reynolds v. Hill, 8 Cir., 184 F.2d 294.

The judgment appealed from is therefore affirmed.

APPENDIX B

Judgment

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 15676 ..... September Term, 1956

Friday, May 3, 1957

ARKANSAS-MISSOURI POWER COMPANY, *Appellant*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, *Appellees.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF ARKANSAS

This cause came on to be heard on the record from the United States District Court for the Eastern District of Arkansas, and was argued by counsel.

On Consideration Whereof, it is now here Ordered and Adjudged by this Court, that the judgment of the said District Court, in this cause, be, and the same is hereby, affirmed.

May 3, 1957.

APPENDIX C

Order Denying Petition of Appellant for Rehearing, etc.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 15676 ..... September Term, 1956

Monday, June 3, 1957

ARKANSAS-MISSOURI POWER COMPANY, *Appellant*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, ET AL., *Appellees.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF ARKANSAS

The petition of the appellant for a rehearing in this cause and the motion of appellant that the said petition be heard by the Court en banc having been considered, it is now here Ordered that the same be, and they are hereby, denied.

June 3, 1957.

APPENDIX D

Statutes and Regulations Involved

REVENUE ACT OF 1936:

Section 112. Recognition of Gain or Loss.

"(a) General Rule:—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

"(b) Exchange Solely in Kind—

* * * *

"(4) Stock for Stock on Reorganization—Gain of Corporation.—No gain or loss shall be recognized if a corporation, a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * *

"(g) Definition of Reorganization.—As used in this section and section 113—

"(1) The term 'reorganization' means . . . (c) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred . . ."

Section 113. Adjusted Basis for Determining Gain or Loss.

"(a) Basis (unadjusted) of Property.—The basis of property shall be the cost of such property; except that— . . .

"(7) Transfers to corporation.—If the property was acquired after December 31, 1917, by a corpora-

tion in connection with a reorganization, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer."

TREASURY REGS. 103:

Section 19.22 (a)—18. *Sale and purchase by corporation of its bonds.*— • • •

• • • •

(3)(a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. • • •

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 330

ARKANSAS-MISSOURI POWER CORPORATION ..... *Petitioner*

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS; HORACE E. THOMPSON, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, AND W. D. SELF, ACTING COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS ..... *Respondents*

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

No. 330

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REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

In an attempt to avoid the conflict between the decision of the Court of Appeals in the instant case and the decision of the Court of Appeals of the Fourth Circuit in the case of *Hummel-Ross Fibre Corporation* v. *Commissioner*, 79

F 2d. 474, the respondents offer and argue two points which they insist distinguish the instant case from the Hummel-Ross case and make that case inapplicable here.

Briefly, the points argued are (1) the absence of arms-length dealing, and (2) the bonds of petitioner were issued as a result of reorganization under § 77B of the Bankruptcy Act. The fallacies of these two points will be discussed in the order stated.

The respondents admit that the Hummel-Ross case, *supra*, sustains Petitioner's argument for apportionment of the fair market value of the property acquired by it between the bonds and stock issued therefor according to their respective market values, but contend that the rule established by that case is not applicable in a situation where bonds and stock are exchanged for property in a transaction, unless it was conducted at arms-length.

Then they assume that the bonds here involved were not issued in an arms-length transaction.

In the Hummel-Ross case, *supra*, discount on two separate and distinct bond issues was involved and the Court upheld the discount on both. The first issue was for $1,000,000 par value of bonds. For these bonds and 2,500 shares of Common Stock of the par value of $100 per share, having a market value of $40 per share, the issuing Company received $1,000,000.

The Court applied the rule of apportionment and allocated the $1,000,000 received for the stock and bonds on the basis of the market value of the stock, and thereby arrived at a discount on the bonds of $100,000.

The second issue of 8% bonds was in the amount of $698,850. The stockholders of the issuing Company paid $698,850 for this issue of bonds plus 1,397.7 of Common

Stock of the par value of $100 per share, which had a market value of $40 per share. The Court applied the same rule of apportionment and approved a discount on the second issue amounting to $55,908.

The details of the foregoing facts, while not appearing in the opinion of the Court, are reflected in the statement of facts found in the opinion of the Board of Tax Appeals, 31 BTA 451.

Thus, it is seen that the stockholders, those in control of the Company, purchased for themselves bonds and stock issued by their Company. There was certainly a fiducairy relation between the stockholders and the Company.

In *Natural Gas Pipeline Company* v. *Commissioner*, 45 BTA 939 (1941), the stockholders of the Pipeline Company surrendered old notes held by them for new notes and Common Stock and the Board of Tax Appeals allowed deductible discount in the amount of the fair market value of the stock received by the stockholders along with the new notes.

In neither of these cases was the arms-length issue raised, although the purchasers of the stock and bonds had absolute control of the issuer and seller thereof and could have dictated the terms of the transactions.

In both the Hummel-Ross case, *supra*, and the Natural Gas case, *supra*, as in the case at bar, the fair market value of the bonds and stock and of that which was received for them was established by findings of fact. These facts were sufficient to establish discount, despite the fiduciary relation between the parties to the transactions.

In the light of the facts found by the trial court (R. 31) and adopted by the Court of Appeals (Pet. 6A and 7A) "*as controlling*" (emphasis supplied), the transaction here

involved has all the earmarks of an arms-length bargain, *Pepper* v. *Litton*, 308 U. S. 295, 306, 84 L. Ed. 281; and meets the test of legality established by this Court. *Geddes* v. *Anaconda Copper Mining Company*, 254 U. S. 590, 599.

Therefore, respondents' position on the question of an arms-length transaction is untenable and is insufficient to escape the application of the apportionment rule established by the Hummel-Ross case, *supra*, and followed in *Pierce Oil Corporation* v. *Commissioner*, 32 BTA 403, and Natural Gas Pipeline Company, *supra*.

Had the rule of apportionment been applied to the controlling facts in the case at bar—and no sound basis for not applying it has been shown—it would have been demonstrated that the Petitioner received for its bonds $425,181 less than their par value, and, therefore, sold them at a discount.

The respondents argue that the bonds were not issued at a discount because they were issued in a reorganization under Section 77B of the Bankruptcy Act, which Act required that the assets of the bankrupt must be used to satisfy its claimants according to the strict priority of their claims. In support of this construction of the Act, they cite *Case* v. *Los Angeles Lumber Company*, 308 U. S. 106, 84 L. Ed. 110. It is true that this case laid down certain strict priority rules that should have been followed in a reorganization under that Act, and because of this requirement, respondents argue that the bondholders of the old company, since they were entitled to satisfaction in full, received such satisfaction, and therefore, Petitioner's bonds were not issued at a discount, notwithstanding the actual facts as found by the Courts below. This contention has no foundation if the plan of reorganization involved here shows that the strict priority rule was not followed.

The Plan of Reorganization approved in the instant case in no respect met the rule laid down in the Los Angeles Lumber Company case, *supra*, and relied upon by the respondents. On the contrary, the debenture and note holders did not receive full satisfaction of their claims although holders of the bankrupt's Preferred Stock were given 2 shares of Common Stock of the new corporation for each share of the Preferred of the old corporation (See page 3, Plan, R 51). Furthermore, on page 2 of the Plan, it is recited as follows:

> "The contributors to the plan have approached the reorganization of the Company with the following objectives in mind: * * Second. A proper distribution should be made to those entitled to participate in the reorganization based on the equities involved *and taking into consideration in the case of Preferred stockholders the value of their cooperation to the Company and its creditors.*" (Emphasis supplied.)

A like provision of the Plan of Reorganization was involved in the Los Angeles case, *supra*, and condemned by this Court.

A study of the Plan here involved discloses that it in no respect met the requirements of Section 77B of the Bankruptcy Act as interpreted and applied by this Court in the Los Angeles case, *supra*, and that it was only an agreed plan such as might have been set up and agreed to by the interested parties without the aid of the District Court, as was done in the Natural Gas Pipeline Company case, *supra*. Without the consent of all parties, the plan here involved could not have withstood an attack.

The Plan, not having been valid, cannot be used or siezed upon to sidestep and distinguish the holding of the Court in the Hummel-Ross case, *supra*, or to avoid the

legal effect of apportionment contended for by petitioner. The refusal of the Court of Appeals to follow the Hummel-Ross case and apply the apportionment rule to the established facts here, creates, under the facts and circumstances, an irreconcilable conflict between the Courts of Appeals of two circuits.

The respondents in a footnote on page 7 of their brief, suggest, if they do not urge, that the Petitioner did not contemplate discount at the time of the bond issue, since it did not set up its books on a discount basis, and therefore, no discount should be recognized.

Whether discount exists or not is not controlled by book entries. *San Joaquin Light and Power Company v. McLaughlin*, 65 F. 2d 677.

For the reasons stated in its petition and in its reply to respondents' brief, it is urged that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1957

ARKANSAS-MISSOURI POWER CORPORATION, PETITIONER

v.

MRS. CLARA K. PASCHAL, ADMINISTRATRIX OF THE ESTATE OF ROY G. PASCHAL, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF ARKANSAS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Regulations involved	2
Statement	3
Argument	5
Conclusion	10

CITATIONS

Cases:

American Smelting & Refining Co. v. *United States*, 130 F. 2d 883 — 9

Case v. *Los Angeles Lumber Co.*, 308 U. S. 106 — 8

Consolidated Rock Co. v. *Du Bois*, 312 U. S. 510 — 8

Group of Investors v. *Milwaukee R. Co.*, 318 U. S. 523 — 8

Helvering v. *Union Pacific Co.*, 293 U. S. 282 — 6

Hummel-Ross Fibre Corp. v. *Commissioner*, 79 F. 2d 474 — 6, 7

Montana Power Co. v. *United States*, 232 F. 2d 541, certiorari denied, 352 U. S. 843 — 7, 9, 10

New York C. & St. L. R. Co. v. *Commissioner*, 23 B. T. A. 177 — 7

Pierce Oil Corp. v. *Commissioner*, 32 B. T. A. 403 — 6

Statute:

Bankruptcy Act, c. 541, 30 Stat. 544, as amended, Sec. 77B — 4, 8, 9

Miscellaneous:

Treasury Regulations 103, Sec. 19.22 (a)–18 — 2, 6, 9

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The memorandum of the District Court (R 23–38) is reported at 144 F. Supp. 272. The opinion of the Court of Appeals (Pet. 1a–9a) is reported at 243 F. 2d 584.

JURISDICTION

The judgment of the Court of Appeals affirming the judgment of the District Court was entered on May 3, 1957. (Pet. 10a.) Taxpayer's petition for rehearing was denied on June 3, 1957. (Pet. 11a.) The petition for certiorari was filed on July

31, 1957. The jurisdiction of this Court is invoked pursuant to 28 U. S. C. 1254.

QUESTION PRESENTED

Whether bonds were issued at a discount when they were issued together with stock in a corporate reorganization under Section 77B of the Bankruptcy Act in exchange for property of the old corporation having a fair market value of more than the face and par values of all the securities issued but less than the fair market value of the stock plus the face value of the bonds.

REGULATIONS INVOLVED

Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939:

> SEC. 19.22 (a)–18. *Sale and purchase by corporation of its bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If the corporation purchases any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (c) If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.
>
> * * * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If the corporation purchases any of such bonds at a

price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (c) If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted), over the purchase price is gain or income for the taxable year.

* * * * *

STATEMENT

The taxpayer, the Arkansas-Missouri Power Corporation, originally instituted four separate suits[1] for refund of income taxes, plus statutory interest, in the total amount of $180,762.22 for the years 1939, 1940, 1941 and 1942. The suits were consolidated for trial in the District Court (R. 23). The relevant facts, as found by the District Court (R. 23–31), may be summarized as follows:

The taxpayer was organized under the laws of the State of Delaware as the successor corporation to the Arkansas-Missouri Power Company, an Arkansas corporation (R. 23). On February 21, 1931, the Arkansas-Missouri Power Company (hereinafter also re-

[1] The actions were brought against former Collectors of Internal Revenue and the Acting Collector of Internal Revenue for the District of Arkansas. For convenience, the Collectors will hereinafter in the brief be referred to as the Government.

ferred to as the old company), filed a petition for reorganization under Section 77B, Chapter VIII, of the Bankruptcy Act (R. 26). On the basis of a valuation by appraisers, a plan of reorganization of the old company was evolved which was approved by the district court (R. 27). The plan was also approved by an order of the Public Utilities Commission of the State of Missouri and by the Department of Public Utilities of the State of Arkansas which directed that the amount of securities to be issued under the plan should not exceed the fair value of the property involved in the reorganization (R. 27-28). In its approval the Missouri Public Utilities Commission also stated that in its opinion the amount of the securities to be issued under the plan does "not exceed the fair value of the property involved." (R. 28-29.)

Pursuant to this plan, the taxpayer corporation was organized and acquired all the properties of the old company, taking title thereto on May 1, 1937. As of May 1, 1937, the taxpayer caused to be issued, in exchange for the property of the old company $2,834,640 of first mortgage five per cent bonds due January 1, 1957; $944,880 of six per cent cumulative preferred stock of a par value of $50 per share; and 165,805 shares of common stock with a $1 per share par value (R. 26-27, 30). It recorded the property acquired by it on its books at $4,493,969.94 and also entered on its books at the time of the reorganization a capital surplus of $548,664.94. The fair market value of this property did not exceed $4,084,587.60, or $409,382.34 less than was recorded on taxpayer's

books (R. 29–30). All of the assets were included in their entirety in the mortgage indenture given by the taxpayer to the trustees to secure the first mortgage bond issue. The fair market value of the bonds issued was $2,409,444 (85% of face value); the fair market value of the preferred stock was $680,313.60 ($36.00 a share); and the fair market value of the common stock was $994,830 ($6.00 a share) (R. 30, 31). The reorganization thus consummated and carried out was a taxable reorganization under the federal tax laws (R. 29). The bonds issued by taxpayer were redeemed by 1940 (R. 31).

The issue presented to the District Court was whether the bonds were issued at a discount which could be amortized and furnish the basis for a deduction from gross income. The District Court held (R. 31–38) that, in the circumstances, the bonds were not issued at a discount and entered judgment for the Government. The Court of Appeals affirmed (Pet. 1a–9a) and on June 3, 1957, denied taxpayer's petition for rehearing (Pet. 11a).

ARGUMENT

The decision of the Court of Appeals, affirming that of the District Court, is correct and is not in conflict with the decision of any other Court of Appeals. There is no basis for further review of this case by this Court.

1. The sole issue is whether the taxpayer corporation issued certain bonds at a discount. Both parties agree, and the Court of Appeals recognized (Pet. 8a), that if the bonds were, in fact, issued at a discount,

according to the applicable Treasury Regulations (Treasury Regulations 103, Sec. 19.22 (a)–18 (3) (a), *supra*, pp. 2–3), such discount could properly be amortized over the life of the bonds and the taxpayer would be entitled to a tax deduction reflecting the amortizable amount. See *Helvering* v. *Union Pacific Co.*, 293 U. S. 282. The District Court and the Court of Appeals held, however, that, in the circumstances of this case, the bonds in question were not issued at a discount. The taxpayer's position that the bonds were issued at a discount depends upon an apportionment of the fair market value of the property acquired by it between the bonds and stock issued by it according to their respective fair market values (Pet. 6). Although this method of determining whether bonds were in fact issued at a discount has been upheld in a situation in which there has been arms-length negotiation resulting in a bargained-for sale of bonds and stock in exchange for cash (cf. *Hammel-Ross Fibre Corp.* v. *Commissioner*, 79 F. 2d 474 (C. A. 4); *Pierce Oil Corp.* v. *Commissioner*, 32 B. T. A. 403, 419–421), it is not a proper one in circumstances such as exist in the instant case.[1]

In order to finance by a bond issue, it is sometimes necessary to sell the bonds at a price lower than their maturity value. This discount factor is in reality an additional interest differential which provides an ad-

[1] It should be noted that in the *Pierce Oil* case, there was no dispute concerning whether the bonds were issued at a discount, but rather the question concerned the amount of the discount. See also the comments of the District Court concerning the cases relied upon by taxpayer (R. 36).

ditional inducement to purchasers.[2] Cf. *Montana Power Co.* v. *United States*, 232 F. 2d 541, 549–550 (C. A. 3), certiorari denied, 352 U. S. 843; *New York C. & St. L. R. Co.* v. *Commissioner*, 23 B. T. A. 177, 196; *Hummel-Ross Fibre Corp.* v. *Commissioner*, *supra*, p. 477. Thus, in the usual case of an arms-length, bargained-for sale of bonds, the method of determining whether the bonds were in fact issued for a cash consideration less than their face value, which the taxpayer advances, might be a proper one. But, in a situation such as exists here, where the bonds were not issued in an arms-length, bargained-for transaction, but rather were issued in the course of a reorganization of a bankrupt debtor to its creditors and where the assets of the old corporation were taken over, the same considerations are not present. The issuance price of a bond issue in these circumstances does not reflect an adjustment of the stated interest rate dictated by the condition of the money market, but rather the entire financing of the newly reorganized corporation is controlled by factors which relate to a sound capitalization and a redistribution of interests in the new corporation among the claimants to the old.[3] No plan of reorganization can be

[2] The record shows that no discount was contemplated at the time of the bond issuance. The taxpayer recorded a capital surplus of $548,664.94 (R. 30). Moreover, the Public Service Commission of the State of Missouri found that the securities issued by the taxpayer did not exceed the fair value of the property involved (R. 28–29).

[3] In the reorganization involved herein the District Court engaged independent appraisers of national reputation to appraise the property of the bankrupt prior to its approval of the plan of reorganization (R. 27).

considered fair and equitable within the meaning of Section 77B of the Bankruptcy Act, *supra*, unless the claims of the creditors of the bankrupt are in fact given strict priority in the new entity arising from the reorganization. *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106; *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523. Before there can be any participation in the new corporation by stockholders of the old, the claims of the creditors of the old company must be fully satisfied. *Consolidated Rock Co.* v. *Du Bois*, 312 U. S. 510.

In a situation such as the present case, the capital structure of the reorganized company, and especially the allocation of capital between bonds and equity securities, is governed by these principles which are substantially different from those governing the usual sale of stocks and bonds for cash. The condition of the money market and other factors which usually determine whether bonds are to be issued at a discount are, at most, secondary considerations in a Section 77B reorganization. The distribution of stock to the prior bondholders gives them an opportunity to participate in subsequent appreciation in values as much as it is a recognition of present worth. All of the assets acquired were included in the mortgage indenture (R. 30) so that the bonds had prior rights to the entire value of the property acquired before the stock had any rights to it. There is therefore no basis for apportioning, as the taxpayer urges, the fair market value of the property acquired between bonds and stocks as though they were being sold to new

investors.[5] It follows that there is no factual basis for the taxpayer's claim that the bonds were issued at a discount.

2. The decision below is not in conflict with that of any other Court of Appeals. None of the cases relied upon by taxpayer to support its apportionment argument involved a situation in which the bond issue arose in a Section 77B reorganization of a bankrupt debtor, which we submit is a crucial factor in this case.[6] Indeed, in *Montana Power Co.* v. *United States*, 232 F. 2d 541, 549 (C. A. 3d), certiorari denied, 352 U. S. 843, three of the judges[7] were of the opinion that the bond discount provisions cannot be invoked in a situation in which there was no arms-length dealing between the seller and purchaser of the bonds. Nor is the decision of the Court of Appeals here in conflict with *American Smelting & Refining Co.* v. *United States*, 120 F. 2d 883 (C. A. 3d), since it is clear from the opinion of the court below that its decision was not based upon the proposition

[5] The fact that the new bonds issued pursuant to the plan of reorganization sold on the open market for eighty-five cents on the dollar (R. 30) has no bearing on whether the bonds were *issued* and paid for at par. Bond discount, as shown by Section 19.22 (a)-18 of Treasury Regulations 103, *supra*, is the excess of the face value over the *issuance* price, and is in no way dependent upon the fair market value. It is obvious that a corporation issuing bonds loses nothing if such bonds are issued at par and immediately thereafter they are sold on the open market by the new owner at a discount.

[6] Taxpayer concedes (Pet. 17) that the question of bond discount arising in a reorganization under Section 77B of the Bankruptcy Act is a novel one.

[7] Judges Kalodner, Staley and Hastie. The Court of Appeals sat *en banc* in its consideration of the case.

that amortizable bond discount cannot arise in an issuance of bonds in exchange for property.[8]

We do not agree that the decision of the court below creates a multitude of problems in the area of amortizable bond discount or has the importance which the taxpayer urges in its petition. The case involves a question which arises only in special circumstances and which, we submit, does not at this time merit consideration by this Court in the absence of a conflict of decisions in the lower courts.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1957.

[8] In the view of at least two judges of the Court of Appeals for the Third Circuit the correctness of this proposition has not been finally resolved in that circuit. See *Montana Power Co.* v. *United States*, 232 F. 2d 541, certiorari denied, 352 U. S. 843.

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